U.S. Auditing Standards — AICPA (Clarified) [AU-C]

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Part I — Statements on Auditing Standards and Sources of Sections in Current Text

Statements on Auditing Standards

Note

This table lists Statements on Auditing Standards (SASs) issued subsequent to SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which was issued in October 2011. Refer to part II, "List of Statements on Auditing Standards Nos. 1–121 and List of Statements on Auditing Procedure Nos. 1–54," of this section for SASs issued prior to SAS No. 122.

No.	Date Issued	Title	AU-C Section
122	Oct. 2011	*Statements on Auditing Standards: Clarification and Recodification*[1]	
123	Oct. 2011	*Omnibus Statement on Auditing Standards — 2011*[2]	
124	Oct. 2011	*Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*	910
125	Dec. 2011	*Alert That Restricts the Use of the Auditor's Written Communication*	905
126	June 2012	*The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern* (Redrafted)	570
127	Jan. 2013	*Omnibus Statement on Auditing Standards — 2013*[3]	
128	Feb. 2014	*Using the Work of Internal Auditors*	610
129	July 2014	*Amendment to Statement on Auditing Standards No. 122 Section 920,* Letters for Underwriters and Certain Other Requesting Parties, *as Amended*	920
130	October 2015	*An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*	940
131	January 2016	*Amendment to Statement on Auditing Standards No. 122 Section 700,* Forming an Opinion and Reporting on Financial Statements	700
132	February 2017	*The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*	570
133	July 2017	*Auditor Involvement With Exempt Offering Documents*	945
134	May 2019	*Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*[4]	700, 701, 705, 706

No.	Date Issued	Title	AU-C Section
135	May 2019	*Omnibus Statement on Auditing Standards — 2019*[5]	
136	July 2019	*Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*[6]	703
137	July 2019	*The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*[7]	720
138	December 2019	*Amendments to the Description of the Concept of Materiality*[8]	
139	March 2020	*Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes From SAS No. 134*[9]	
140	April 2020	*Amendments to AU-C Sections 725, 730, 930, 935, and 940 to Incorporate Auditor Reporting Changes From SAS Nos. 134 and 137*[10]	
141	May 2020	*Amendment to the Effective Dates of SAS Nos. 134–140*[11]	
142	July 2020	*Audit Evidence*[12]	500
143	July 2020	*Auditing Accounting Estimates and Related Disclosures*[13]	540
144	June 2021	*Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources*[14]	
145	October 2021	*Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*[15]	315
146	June 2022	*Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*[16]	220
147	June 2022	*Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations*[17]	
148	August 2022	*Amendment to AU-C Section 935*[18]	
149	March 2023	*Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*[19]	600

[1]SAS No. 122 created various sections throughout *U.S. Auditing Standards — AICPA (Clarified)*. See the following section, "Sources of Sections in Current Text," for a full list.

[2]SAS No. 123 has been integrated within sections 200.03, 200.15, 200.A17, 230.19, 260.12, 260.A27, 705.16, 705.A19, 720.10–.11, 720.A4, 915.09, 915.14, 935.30–.31, and 935.A41.

[3]SAS No. 127 has been integrated within sections 600.25–.26, 600.28, 600.32, 600.50, 600.A53–.A57, 600.A60, 600.A97, 800.01, 800.07, 800.11, 800.18, 800.20, 800.A4–.A5, 800.A8, 800.A24, and 800.A33.

[4]SAS No. 134 has also been integrated within sections 200.14, 210A.10, 210A.A9, 210A.A23–.A24, 210A.A43, 220A.22, 220A.A28, 230.A12, 230.A30, 240.15, 240.A6, 240.A13, 260.03, 260.10–.12, 260.14, 260.A13, 260.A17, 260.A20–.A22, 260.A24, 260.A26–.A28, 260.A30, 260.A32–.A36, 260.A40, 260.A48, 260.A50, 260.A57, 300.A15–.A16, 300.A27, 315.19, 315.27, 315.A1, 315.A19–.A20, 315.A28, 315.A31–.A32, 315.A83, 315.A94–.A95, 315.A99, 315.A106, 315.A127, 315.A131–.A134, 315.A139–.A143, 315.A147, 315.A167, 320.06, 320.A1, 320.A13, 330.21, 330.26, 330.33, 330.A14–.A15, 330.A57, 330.A72, 450.04, 450.A1–.A6, 450.A9, 450.A22–.A24, 450.A29, 510.A18, 510.A20, 540.A18, 540.A120, 570.24–.26, 570.29–.30, 570.A51–.A52, 570.A54–.A57,570.A62, 570.A65, 600.A97, and 910.A11.

[5]SAS No. 135 has been integrated within sections 210A.A32, 240.11, 240.17, 240.19, 240.21, 240.32, 240.A19, 240.A54–.A55, 240.A72, 240.A76, 260.12–.13, 260.17, 260.21, 260.A30, 265.A8, 315.29, 315.A36, 315.A148–.A149, 315.A153, 330.A58–.A59, 510.A5, 550.01, 550.14–.18, 550.20, 550.22–.23, 550.26, 550.29, 550.A3, 550.A11, 550.A14, 550.A16–.A18, 550.A20, 550.A22, 550.A26–.A29, 550.A36, 550.A42–.A45, 550.A52–.A53, 560.A6, 580.17, 580.A16, 580.A18, 600.41, 600.A94, 930.22, 930.A32, 930.A59, 940.A25, and 940.A91.

[6]SAS No. 136 has also been integrated within sections 200.A50, 220A.A25, 240.A62, 330.01, 450.01, 450.09,450.A15, 501.A53, 501.A65, 510.01, 510.A15, 540.A133, 550.02, 550.28, 560.03, 560.07, 560.A10, 560.A14, 560.A30, 570.A37, 570.A60, 580.A38, 708.A9, and 725.01.

[7]SAS No. 137 has also been integrated within sections 210A.06, 210A.A17, 210A.A44, 230.A30, 260.A22, 260.A58, 450.A28, 600.A97, 700.38, 700.A2, 700.A81, 705.30, 705.A36, 705.A38, 706.03, 706.A17, 725.A2, 730.A1, 810.27, 810.A20, 945.09, and 945.A27.

[8]SAS No. 138 has been integrated within sections 200.07, 320.02, 320.04, 320.10, 320.A12, 450.A23, 600.32, 600.A63, 700.35, 700.A14, 703.74, 703.114, and 703.A69.

[9]SAS No. 139 has been integrated within sections 800.01, 800.03, 800.07–.09, 800.14–.16, 800.18–.21, 800.23, 800.A2–.A6, 800.A11–.A12, 800.A18–.A22, 800.A25, 800.A28, 800.A34, 800.A39–.A41, 805.06, 805.15, 805.19, 805.21, 805.A1–.A4, 805.A8, 805.A11, 805.A13–.A15, 805.A17–.A18, 805.A20–.A21, 805.A23–.A26, 805.A28–.A29, 805.A32–.A34, 810.10, 810.15, 810.18–.20, 810.26, 810.A1, 810.A15–.A16, 810.A24.

[10]SAS No. 140 has been integrated within sections 703.127, 703.A148, 703.A154, 706.A19, 725.09, 725.A17, 730.07–.09, 730.A3, 910.A11, 920.29, 920.A29, 930.31, 930.38–.39, 930.A41, 930.A45–.A60, 930.A68–.A70, 930.A79–.A81, 935.04, 935.08, 935.10–.11, 935.16–.17, 935.23, 935.30–.31, 935.34–.35, 935.38, 935.A1–.A2, 935.A7, 935.A9–.A11, 935.A16–.A17, 935.A21, 935.A24–.A26, 935.A34–.A35, 935.A37–.A38, 935.A42–.A44, 940.64–.66, 940.69–.71, 940.75–.76, 940.80, 940.86, 940.A113, 940.A117, 940.A121–.A122, 940.A130, 940.A155, and 940.A158.

[11]SAS No. 141 has been integrated within sections 700.08, 701.05, 703.13, 705.04, 706.05, and 720.10. Additionally, SAS No. 141 revises the effective dates of the amendments listed in footnotes 4–10 of this section.

[12]SAS No. 142 has been integrated within sections 200.14, 200.19, 200.A26–.A27, 200.A76, 230.06, 315.A81, 330.06, 330.28, 330.A48, 330.A51–.A52, 330.A59, 330.A66, 330.A75, 330.A77, 501.01, 501.03–.04, 501.26, 501.A69–.A83, 530.02, 540.A28, and 540.A70.

[13]SAS No. 143 has been integrated within sections 200.A44, 230.A9, 230.A12, 230.A30, 240.A53, 260.A27–.A28, 260.A56–.A57, 501.01, 501.04, 501.06–.10, 501.A1–.A2, 501.A5–.A6, 501.A8, 501.A11–.A19, sections 580.16, 580.A13–.A14, 580.A35, 700.15*c*, 701.08*b*, the title before 701.A21, and section 703.40.

[14]SAS No. 144 has been integrated within sections 501.03, 501.27, 501.A29–.A31, 501.A71–.A72, 501.A79, 501.A81, 501.A84–.A88, 540.A107, 540.A127–.A128, 540.A154, 620.A10, 620.A20–.A22, 620.A30–.A31, 620.A35, 620.A40–.A41, 620.A43, and 620.A45.

[15]SAS No. 145 has been integrated within sections 200.08, 200.14, 200.A15, 200.A44–.A47, 200.A67, 200.A72–.A74, 210.A16, 230.A20, 240.07, 240.16, 240.20, 240.27, 240.32, 240.43, 240.A9, 240.A21–.A22, 240.A27, 240.A30, 240.A37, 240.A48–.A49, 240.A76–.A77, 250.A24, 260.A20–.A21, 265.01–.02, 265.07, 265.A1, 265.A4, 265.A11, 300.A26, 330.07–.08, 330.10, 330.13, 330.15–.18, 330.29, 330.A1, 330.A4, 330.A7, 330.A10–.A11, 330.A19, 330.A21, 330.A25, 330.A29, 330.A32–.A37, 330.A40–.A41, 330.A43, 330.A47, 330.A50–.A51, 330.A64, 330.A66, 330.A76, 330.A79–.A80, 402.01, 402.03, 402.07, 402.10–.12, 402.14, 402.17, 402.A14, 402.A19, 402.A24, 402.A31–.A32, 402.A35–.A36, 402.A41, 500.A67, 501.A24, 505.03, 530.A10, 540.04–.05, 540.07, 540.12, 540.15–.16, 540.18, 540.A8–.A10, 540.A19–.A21, 540.A24–.A25, 540.A29, 540.A35, 540.A39, 540.A44, 540.A50–.A54, 540.A64–.A66, 540.A68, 540.A70, 540.A79, 540.A85, 550.A7, 550.A10, 550.A21, 550.A30, 550.A38, 600.20, 600.A7, 600.A94, 600.A96, 610.05, 610.A3, 610.A12, and 610.A26, 620.A5, 701.A18, 703.18, 703.20, 703.A19–.A20, 703.A153, 720.A34, 720.A55, 805.A7, 930.11, 930.A7, and 930.A11, 940.26, 940.31, 940.57, 940.A6, 940.A22, 940.A26–.A27, 940.A34, and 940.A51–.A52.

[16]SAS No. 146 has also been integrated within sections 200.A20, 200.A32, 210.A1, 230.03, 230.A9, 230.A15, 230.A23–.A24, 230.A27–.A28, 260.A37, 260.A51, 300.02, 300.06, 300.08-.09, 300.11, 300.14, 300.A1–.A2, 300.A4, 300.A7–.A11, 300.A20–.A21, 300.A24–.A26, 300.A30, 500.A68, 600.05, 620.08, 620.A7, 620.A11–.A14, 620.A16, 620.A29, 700.A39, 700.A54, 701.A13, 701.A60, and 701.A62, 703.A119, 720.A27, 930.A60, 935.A35, 940.A117.
The amendments in SAS No. 146 are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to these sections.

Section 220A has been added to retain currently effective content until SAS No. 146 becomes effective.

[17]SAS No. 147 has been integrated within section 210.11–.13, .15, and .A30–.A35.

[18]SAS No. 148 has been integrated within section 935.02, .12, .16, .18–.21, .24, .44, .A12, .A14–.A16, .A18–.A19, .A25, and .A45–.A46.

[19]SAS No. 149 has also been integrated within sections 220.A1, 220.A22–.A23, 220.A26–.A27, 220.A55–.A56, 220.A62, 220.A95, 220.A101, 230.A30, 260.A9, 260.A58, 300.01, 300.11, 300.A10, 300.A30, 315.A17, 315.A53, 315.A247, 320.09, 320.A15, 402.A19, 450.A25, 501.A5, 501.A23, 510.A8, 550.A11, 550.A31, 550.A42, 610.A20, 700.A39, 700.A81, 701.A13, 705.A11, 705.A38, 720.A2, 720.A36, 720.A39–.A40, 805.02, 920.21, 920.A19, 920.A27, 920.A70, 920.A93, 920.A93-14, 930.14, 930.A17, 930.A55, 930.A79, 935.15, 935.A12–.A13, 935.A47, 940.67, 940.78–.79, 940.81–.83, 940.A128–.A130, 940.A133–.A136, and 940.A156.
The amendments to sections 220 and 930 are effective on or after December 15, 2025.

All other amendments are effective on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to these sections.

Section 600A has been added to retain currently effective content until SAS No. 149 becomes effective.

Sources of Sections in Current Text

AU-C Section	Contents	Source	Amended By
200–299	**General Principles and Responsibilities**		
200	*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*	SAS No. 122	SAS Nos. 123, 128, 130, 134, 136, 138, 142. 143, 145
210	*Terms of Engagement*	SAS No. 122	SAS Nos. 134, 135, 137, 138, 145, 147
220	*Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*	SAS No. 146	SAS No. 149
220A	*Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*	SAS No. 122	SAS Nos. 128, 134, 136
230	*Audit Documentation*	SAS No. 122	SAS Nos. 123, 128, 134, 137, 142, 143, 145
240	*Consideration of Fraud in a Financial Statement Audit*	SAS No. 122	SAS Nos. 128, 134, 135, 136, 143, 145
250	*Consideration of Laws and Regulations in an Audit of Financial Statements*	SAS No. 122	SAS No. 145
260	*The Auditor's Communication With Those Charged With Governance*	SAS No. 122	SAS Nos. 123, 125, 128, 134, 135, 137, 143, 145
265	*Communicating Internal Control Related Matters Identified in an Audit*	SAS No. 122	SAS Nos. 125, 128, 130, 135, 145
300–499	**Risk Assessment and Response to Assessed Risks**		
300	*Planning an Audit*	SAS No. 122	SAS Nos. 128, 134, 145
315	*Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*	SAS No. 145	
320	*Materiality in Planning and Performing an Audit*	SAS No. 122	SAS Nos. 134, 138
330	*Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*	SAS No. 122	SAS Nos. 134, 135, 136, 142, 145
402	*Audit Considerations Relating to an Entity Using a Service Organization*	SAS No. 122	SAS Nos. 128, 130, 145
450	*Evaluation of Misstatements Identified During the Audit*	SAS No. 122	SAS Nos. 134, 135, 136, 137, 138
500–599	**Audit Evidence**		
500	*Audit Evidence*	SAS No. 142	
501	*Audit Evidence — Specific Considerations for Selected Items*	SAS No. 122	SAS Nos. 136, 142, 143, 144, 145

AU-C Section	Contents	Source	Amended By
505	*External Confirmations*	SAS No. 122	SAS No. 145
510	*Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*	SAS No. 122	SAS Nos. 134, 135, 136, 138
520	*Analytical Procedures*	SAS No. 122	
530	*Audit Sampling*	SAS No. 122	SAS Nos. 142, 145
540	*Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*	SAS No. 143	SAS Nos. 144, 145
550	*Related Parties*	SAS No. 122	SAS Nos. 128, 135, 136, 145
560	*Subsequent Events and Subsequently Discovered Facts*	SAS No. 122	SAS Nos. 133, 135, 136
570	*The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern*	SAS No. 132	SAS Nos. 134, 136
580	*Written Representations*	SAS No. 122	SAS Nos. 135, 136, 145
585	*Consideration of Omitted Procedures After the Report Release Date*	SAS No. 122	
600–699	**Using the Work of Others**		
600	*Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*	SAS No. 149	
600A	*Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*	SAS No. 122	SAS Nos. 127, 128, 130, 134, 135, 137, 138, 145
610	*Using the Work of Internal Auditors*	SAS No. 128	SAS No. 145
620	*Using the Work of an Auditor's Specialist*	SAS No. 122	SAS Nos. 144, 145
700–799	**Audit Conclusions and Reporting**		
700	*Forming an Opinion and Reporting on Financial Statements*	SAS No. 134	SAS Nos. 137, 138, 141, 143
701	*Communicating Key Audit Matters in the Independent Auditor's Report*	SAS No. 134	SAS Nos. 141, 143, 145
703	*Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*	SAS No. 136	SAS Nos. 138, 140, 141, 143, 145
705	*Modifications to the Opinion in the Independent Auditor's Report*	SAS No. 134	SAS Nos. 137, 141
706	*Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*	SAS No. 134	SAS Nos. 137, 140, 141
708	*Consistency of Financial Statements*	SAS No. 122	SAS No. 136
720	*The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*	SAS No. 137	SAS Nos. 141, 145

AU-C Section	Contents	Source	Amended By
725	*Supplementary Information in Relation to the Financial Statements as a Whole*	SAS No. 119[20]	SAS Nos. 122, 125, 136, 137, 140
730	*Required Supplementary Information*	SAS No. 120[21]	SAS Nos. 122, 137, 140
800–899	**Special Considerations**		
800	*Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*	SAS No. 122	SAS Nos. 125, 127, 132, 139
805	*Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*	SAS No. 122	SAS No. 139, 145
806	*Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*	SAS No. 122	SAS No. 125
810	*Engagements to Report on Summary Financial Statements*	SAS No. 122	SAS Nos. 137, 139
900–999	**Special Considerations in the United States**		
905	*Alert That Restricts the Use of the Auditor's Written Communication*	SAS No. 125	SAS No. 130
910	*Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*	SAS No. 124	SAS Nos. 134, 138, 140
915	*Reports on Application of Requirements of an Applicable Financial Reporting Framework*	SAS No. 122	SAS Nos. 123, 125
920	*Letters for Underwriters and Certain Other Requesting Parties*	SAS No. 122	SAS Nos. 125, 129, 140
925	*Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*	SAS No. 122	SAS No. 133
930	*Interim Financial Information*	SAS No. 122	SAS Nos. 132, 135, 140, 145
935	*Compliance Audits*	SAS No. 117[22]	SAS Nos. 122, 123, 125, 130, 140, 148
940	*An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*	SAS No. 130	SAS Nos. 135, 140, 145
945	*Auditor Involvement With Exempt Offering Documents*	SAS No. 133	SAS No. 137

[20]To address practice issues, SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 119 was previously codified as AU section 551 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C Foreword. SAS No. 122 redesignated AU section 551 as AU-C section 725 but did not supersede SAS No. 119. AU-C section 725 contains conforming changes necessary due to the issuance of SAS No. 122.

[21]To address practice issues, SAS No. 120, *Required Supplementary Information*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 120 was previously codified as AU section 558 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C

Foreword. SAS No. 122 redesignated AU section 558 as AU-C section 730 but did not supersede SAS No. 120. AU-C section 730 contains conforming changes necessary due to the issuance of SAS No. 122.

[22]To address practice issues, SAS No. 117, *Compliance Audits*, was issued in December 2009 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for compliance audits for fiscal periods ending on or after June 15, 2010. SAS No. 117 was previously codified as AU section 801 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C Foreword. SAS No. 122 redesignated AU section 801 as AU-C section 935 but did not supersede SAS No. 117. AU-C section 935 contains conforming changes necessary due to the issuance of SAS No. 122.

Part II — List of Statement on Auditing Standards Nos. 1–121 and List of Statement on Auditing Procedure Nos. 1–54

Statement on Auditing Procedure Nos. 1–54

No.	Date Issued	Title
1	Oct. 1939	*Extensions of Auditing Procedure*
2	Dec. 1939	*The Auditor's Opinion on the Basis of a Restricted Examination*
3	Feb. 1940	*Inventories and Receivables of Department Stores, Installment Houses, Chain Stores, and Other Retailers*
4	Mar. 1941	*Clients' Written Representations Regarding Inventories, Liabilities, and Other Matters*
5	Feb. 1941	*The Revised SEC Rule on "Accountants' Certificates"*
6	Mar. 1941	*The Revised SEC Rule on "Accountants' Certificates"*
7	Mar. 1941	*Contingent Liability Under Policies With Mutual Insurance Companies*
8	Sept. 1941	*Interim Financial Statements and the Auditor's Report Thereon*
9	Dec. 1941	*Accountants' Reports on Examinations of Securities and Similar Investments Under the Investment Company Act*
10	June 1942	*Auditing Under Wartime Conditions*
11	Sept. 1942	*The Auditor's Opinion on the Basis of a Restricted Examination (No. 2)*
12	Oct. 1942	*Amendment to Extensions of Auditing Procedure*
13	Dec. 1942	*The Auditor's Opinion on the Basis of a Restricted Examination (No. 3) Face-Amount Certificate Companies*
14	Dec. 1942	*Confirmation of Public Utility Accounts Receivable*
15	Dec. 1942	*Disclosure of the Effect of Wartime Uncertainties on Financial Statements*
16	Dec. 1942	*Case Studies on Inventories*
17	Dec. 1942	*Physical Inventories in Wartime*
18	Jan. 1943	*Confirmation of Receivables From the Government*
19	Nov. 1943	*Confirmation of Receivables (Positive and Negative Methods)*
20	Dec. 1943	*Termination of Fixed Price Supply Contracts*
21	July 1944	*Wartime Government Regulations*
22	May 1945	*References to the Independent Accountant in Securities Registrations*
23	Dec. 1949	*Clarification of Accountant's Report When Opinion is Omitted (Revised)*
24	Oct. 1948	*Revision in Short-Form Accountant's Report or Certificate*
25	Oct. 1954	*Events Subsequent to the Date of Financial Statements*
26	Apr. 1956	*Reporting on Use of "Other Procedures"*
27	July 1957	*Long-Form Reports*
28	Oct. 1957	*Special Reports*
29	Oct. 1958	*Scope of the Independent Auditor's Review of Internal Control*

No.	Date Issued	Title
30	Sept. 1960	*Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements*
31	Oct. 1961	*Consistency*
32	Sept. 1962	*Qualifications and Disclaimers*
33	Dec. 1963	*Auditing Standards and Procedures (a codification)*
34	Sept. 1965	*Long-Term Investments*
35	Nov. 1965	*Letters for Underwriters*
36	Aug. 1966	*Revision of "Extensions of Auditing Procedure" Relating to Inventories*
37	Sept. 1966	*Special Report: Public Warehouses Controls and Auditing Procedures for Goods Held*
38	Sept. 1967	*Unaudited Financial Statements*
39	Sept. 1967	*Working Papers*
40	Oct. 1968	*Reports Following a Pooling of Interests*
41	Oct. 1969	*Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*
42	Jan. 1970	*Reporting When a Certified Public Accountant Is Not Independent*
43	Sept. 1970	*Confirmation of Receivables and Observation of Inventories*
44	Apr. 1971	*Reports Following a Pooling of Interests*
45	July 1971	*Using the Work and Reports of Other Auditors*
46	July 1971	*Piecemeal Opinions*
47	Sept. 1971	*Subsequent Events*
48	Oct. 1971	*Letters for Underwriters*
49	Nov. 1971	*Reports on Internal Control*
50	Nov. 1971	*Reporting on the Statement of Changes in Financial Position*
51	July 1972	*Long-Term Investments*
52	Oct. 1972	*Reports on Internal Control Based on Criteria Established by Governmental Agencies*
53	Nov. 1972	*Reporting on Consistency and Accounting Changes*
54	Nov. 1972	*The Auditor's Study and Evaluation of Internal Control*

Statement on Auditing Standards Nos. 1–121

No.	Date Issued	Title
1	Nov. 1972	*Codification of Auditing Standards and Procedures*
2	Oct. 1974	*Reports on Audited Financial Statements*
3	Dec. 1974	*The Effects of EDP on the Auditor's Study and Evaluation of Internal Control*
4	Dec. 1974	*Quality Control Considerations for a Firm of Independent Auditors*
5	July 1975	*The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*
6	July 1975	*Related Party Transactions*
7	Oct. 1975	*Communications Between Predecessor and Successor Auditors*
8	Dec. 1975	*Other Information in Documents Containing Audited Financial Statements*
9	Dec. 1975	*The Effect of an Internal Audit Function on the Scope of the Independent Auditor's Examination*
10	Dec. 1975	*Limited Review of Interim Financial Information*
11	Dec. 1975	*Using the Work of a Specialist*
12	Jan. 1976	*Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*
13	May 1976	*Reports on a Limited Review of Interim Financial Information*
14	Dec. 1976	*Special Reports*
15	Dec. 1976	*Reports on Comparative Financial Statements*
16	Jan. 1977	*The Independent Auditor's Responsibility for the Detection of Errors or Irregularities*
17	Jan. 1977	*Illegal Acts by Clients*
18	May 1977	*Unaudited Replacement Cost Information*
19	June 1977	*Client Representations*
20	Aug. 1977	*Required Communication of Material Weaknesses in Internal Accounting Control*
21	Dec. 1977	*Segment Information*
22	Mar. 1978	*Planning and Supervision*
23	Oct. 1978	*Analytical Review Procedures*
24	Mar. 1979	*Review of Interim Financial Information*
25	Nov. 1979	*The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*
26	Nov. 1979	*Association With Financial Statements*
27	Dec. 1979	*Supplementary Information Required by the Financial Accounting Standards Board*
28	June 1980	*Supplementary Information on the Effects of Changing Prices*
29	July 1980	*Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*
30	July 1980	*Reporting on Internal Accounting Control*
31	Aug. 1980	*Evidential Matter*
32	Oct. 1980	*Adequacy of Disclosure of Financial Statements*
33	Oct. 1980	*Supplementary Oil and Gas Reserve Information*

No.	Date Issued	Title
34	Mar. 1981	*The Auditor's Considerations When a Question Arises About an Entity's Continued Existence*
35	April 1981	*Special Reports — Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*
36	April 1981	*Review of Interim Financial Information*
37	April 1981	*Filings Under Federal Securities Statutes*
38	April 1981	*Letters for Underwriters*
39	June 1981	*Audit Sampling*
40	Feb. 1982	*Supplementary Mineral Reserve Information*
41	April 1982	*Working Papers*
42	Sept. 1982	*Reporting on Condensed Financial Statements and Selected Financial Data*
43	Aug. 1982	*Omnibus Statement on Auditing Standards*
44	Dec. 1982	*Special-Purpose Reports on Internal Accounting Control at Service Organizations*
45	Aug. 1983	*Omnibus Statement on Auditing Standards — 1983*
46	Sept. 1983	*Consideration of Omitted Procedures After the Report Date*
47	Dec. 1983	*Audit Risk and Materiality in Conducting an Audit*
48	July 1984	*The Effects of Computer Processing on the Audit of Financial Statements*
49	Sept. 1984	*Letters for Underwriters*
50	July 1986	*Reports on the Application of Accounting Principles*
51	July 1986	*Reporting on Financial Statements Prepared for Use in Other Countries*
52	April 1988	*Omnibus Statement on Auditing Standards — 1987*
53	April 1988	*The Auditor's Responsibility to Detect and Report Errors and Irregularities*
54	April 1988	*Illegal Acts by Clients*
55	April 1988	*Consideration of Internal Control in a Financial Statement Audit*
56	April 1988	*Analytical Procedures*
57	April 1988	*Auditing Accounting Estimates*
58	April 1988	*Reports on Audited Financial Statements*
59	April 1988	*The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
60	April 1988	*Communication of Internal Control Related Matters Noted in an Audit*
61	April 1988	*Communication With Audit Committees*
62	April 1989	*Special Reports*
63	April 1989	*Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*
64	Dec. 1990	*Omnibus Statement on Auditing Standards — 1990*
65	April 1991	*The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*
66	June 1991	*Communication of Matters About Interim Financial Information Filed or to Be Filed With Specified Regulatory Agencies — An Amendment to SAS No. 36,* Review of Interim Financial Information
67	Nov. 1991	*The Confirmation Process*
68	Dec. 1991	*Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*

No.	Date Issued	Title
69	Jan. 1992	*The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles
70	April 1992	*Service Organizations*
71	May 1992	*Interim Financial Information*
72	Feb. 1993	*Letters for Underwriters and Certain Other Requesting Parties*
73	July 1994	*Using the Work of a Specialist*
74	Feb. 1995	*Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*
75	Sept. 1995	*Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement*
76	Sept. 1995	*Amendments to Statement on Auditing Standards No. 72,* Letters for Underwriters and Certain Other Requesting Parties
77	Nov. 1995	*Amendments to Statements on Auditing Standards No. 22,* Planning and Supervision, *No. 59,* The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, *and No. 62,* Special Reports
78	Dec. 1995	*Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55*
79	Dec. 1995	*Amendment to Statement on Auditing Standards No. 58,* Reports on Audited Financial Statements
80	Dec. 1996	*Amendment to Statement on Auditing Standards No. 31,* Evidential Matter
81	Dec. 1996	*Auditing Investments*
82	Feb. 1997	*Consideration of Fraud in a Financial Statement Audit*
83	Oct. 1997	*Establishing an Understanding With the Client*
84	Oct. 1997	*Communications Between Predecessor and Successor Auditors*
85	Nov. 1997	*Management Representations*
86	Mar. 1998	*Amendment to Statement on Auditing Standards No. 72,* Letters for Underwriters and Certain Other Requesting Parties
87	Sept. 1998	*Restricting the Use of an Auditor's Report*
88	Dec. 1999	*Service Organizations and Reporting on Consistency*
89	Dec. 1999	*Audit Adjustments*
90	Dec. 1999	*Audit Committee Communications*
91	Apr. 2000	*Federal GAAP Hierarchy*
92	Sept. 2000	*Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*
93	Oct. 2000	*Omnibus Statement on Auditing Standards — 2000*
94	May 2001	*The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit*
95	Dec. 2001	*Generally Accepted Auditing Standards*
96	Jan. 2002	*Audit Documentation*
97	June 2002	*Amendment to Statement on Auditing Standards No. 50,* Reports on the Application of Accounting Principles
98	Sept. 2002	*Omnibus Statement on Auditing Standards — 2002*
99	Oct. 2002	*Consideration of Fraud in a Financial Statement Audit*
100	Nov. 2002	*Interim Financial Information*

No.	Date Issued	Title
101	Jan. 2003	*Auditing Fair Value Measurements and Disclosures*
102	Dec. 2005	*Defining Professional Requirements in Statements on Auditing Standards*
103	Dec. 2005	*Audit Documentation*
104	Mar. 2006	*Amendment to Statement on Auditing Standards No. 1,* Codification of Auditing Standards and Procedures *("Due Professional Care in the Performance of Work")*
105	Mar. 2006	*Amendment to Statement on Auditing Standards No. 95,* Generally Accepted Auditing Standards
106	Mar. 2006	*Audit Evidence*
107	Mar. 2006	*Audit Risk and Materiality in Conducting an Audit*
108	Mar. 2006	*Planning and Supervision*
109	Mar. 2006	*Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
110	Mar. 2006	*Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
111	Mar. 2006	*Amendment to Statement on Auditing Standards No. 39,* Audit Sampling
112	May 2006	*Communicating Internal Control Related Matters Identified in an Audit*
113	Nov. 2006	*Omnibus Statement on Auditing Standards — 2006*
114	Dec. 2006	*The Auditor's Communication With Those Charged With Governance*
115	Sept. 2008	*Communicating Internal Control Related Matters Identified in an Audit*
116	Feb. 2009	*Interim Financial Information*
117	Dec. 2009	*Compliance Audits*
118	Feb. 2010	*Other Information in Documents Containing Audited Financial Statements*
119	Feb. 2010	*Supplementary Information in Relation to the Financial Statements as a Whole*
120	Feb. 2010	*Required Supplementary Information*
121	Feb. 2011	*Revised Applicability of Statement on Auditing Standards No. 100,* Interim Financial Information

AU-C INTRODUCTION

Foreword

Authority of the SASs

SASs are issued by the ASB, the senior committee of the AICPA designated to issue pronouncements on auditing matters applicable to the preparation and issuance of audit reports for entities not subject to the oversight authority of the PCAOB (that is, those entities whose audits are not within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended). The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit (the auditor) of the financial statements of a nonissuer[1] to comply with standards promulgated by the ASB. An auditor must comply with an unconditional requirement in all cases in which such requirement is relevant. An auditor also must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant. However, if, in rare circumstances, an auditor judges it necessary to depart from a relevant presumptively mandatory requirement, the auditor must document the justification for the departure and how the alternative audit procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Exhibits and interpretations to SASs are *interpretive publications*, as defined in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit. Interpretive publications are not auditing standards. Interpretive publications are recommendations on the application of the SASs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SASs. Auditing interpretations of the generally accepted auditing standards are included in AU-C sections. AICPA Audit and Accounting Guides and Auditing Statements of Position are listed in AU-C appendix D, *AICPA Audit and Accounting Guides and Statements of Position*.

AUDITING STANDARDS BOARD

Tracy W. Harding, *Chair*

Jennifer Burns, Chief Auditor — AICPA

[1]See the definition of the term *nonissuer* in the AU-C Glossary.

AU-C Preface

Principles Underlying an Audit Conducted in Accordance With Generally Accepted Auditing Standards

This preface contains the principles underlying an audit conducted in accordance with generally accepted auditing standards (the principles). These principles are not requirements and do not carry any authority.

The Auditing Standards Board has developed the principles to provide a framework that is helpful in understanding and explaining an audit. The principles are organized to provide a structure for the codification of Statements on Auditing Standards. This structure addresses the purpose of an audit (purpose), personal responsibilities of the auditor (responsibilities), auditor actions in performing the audit (performance), and reporting (reporting).

Purpose of an Audit and Premise Upon Which an Audit Is Conducted

.01 The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. An auditor's opinion enhances the degree of confidence that intended users can place in the financial statements.

.02 An audit in accordance with generally accepted auditing standards is conducted on the premise that management and, when appropriate, those charged with governance, have responsibility

a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;

b. for 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; and

c. to provide the auditor with

    i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;

ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Responsibilities

.03 Auditors are responsible for having appropriate competence and capabilities to perform the audit; complying with relevant ethical requirements; and maintaining professional skepticism and exercising professional judgment throughout the planning and performance of the audit.

Performance

.04 To express an opinion, the auditor obtains reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

.05 To obtain reasonable assurance, which is a high, but not absolute, level of assurance, the auditor

- plans the work and properly supervises any assistants.
- determines and applies appropriate materiality level or levels throughout the audit.
- identifies and assesses risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- obtains sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.

.06 The auditor is unable to obtain absolute assurance that the financial statements as a whole are free from material misstatement because of inherent limitations, which arise from

- the nature of financial reporting;
- the nature of audit procedures; and
- the need for the audit to be conducted within a reasonable period of time and so as to achieve a balance between benefit and cost.

Reporting

.07 Based on an evaluation of the audit evidence obtained, the auditor expresses, in the form of a written report, an opinion in accordance with the auditor's findings, or states that an opinion cannot be expressed. The opinion states whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

AU-C Glossary

Glossary of Terms[1,2]

accounting and auditing practice.[3] A practice that performs engagements covered by QM section 10A, *A Firm's System of Quality Control*, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

accounting estimate. A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty.

accounting records. The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records, such as work sheets and spreadsheets, supporting cost allocations, computations, reconciliations, and disclosures.

accounts receivable (in the context of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*). The entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and a financial institution's loans.

acknowledgment letter. See **awareness letter**.

advisory accountant. See **reporting accountant**.

aggregation risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.

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[1]Unless otherwise indicated, this glossary lists the terms defined for purposes of generally accepted auditing standards (GAAS) in AU-C sections as designated by Statement on Auditing Standards No. 122, *Statements on Auditing Standards: Clarification and Recodification*, and also lists certain terms included by the Auditing Standards Board. Terms defined for purposes of a specific AU-C section or for purposes of adapting GAAS to a compliance audit (section 935, *Compliance Audits*) are denoted as such. Terms may appear in more than one AU-C section.

[2]This glossary also lists terms defined in clarified QM section 10A, *A Firm's System of Quality Control*, for purposes of the Statements on Quality Control Standards (SQCSs). Terms defined in AU-C sections and in QM section 10A are denoted as such.

[3]Term defined in paragraph .13 of QM section 10A for purposes of SQCSs.

analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

The use of analytical procedures as risk assessment procedures may be referred to as *analytical procedures used to plan the audit*. The auditor's use of analytical procedures as substantive procedures is referred to as *substantive analytical procedures*. Also see **risk assessment procedures, scanning,** and **substantive procedure**.

analytical procedures used to plan the audit. See **analytical procedures**.

annual report. A document, or combination of documents, typically prepared on an annual basis by management or those charged with governance in accordance with law, regulation, or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains, accompanies, or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public.

applicable compliance requirements (in the context of adapting generally accepted auditing standards [GAAS] to a compliance audit). Compliance requirements that are subject to the compliance audit.

applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. The term also means the financial reporting framework that applies to the group financial statements. Also see **financial reporting framework**.

applied criteria (in the context of section 810, *Engagements to Report on Summary Financial Statements*). The criteria applied by management in the preparation of the summary financial statements.

appropriateness (of audit evidence). The measure of the quality of audit evidence that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. Also see **audit evidence**.

arm's length transaction. A transaction conducted on such terms and conditions between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

assertions. Representations, explicit or otherwise, with respect to the recognition, measurement, presentation, and disclosure of information in the financial statements, which are inherent in management, representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing, and responding to the risks of material misstatement.

audit documentation. The record of audit procedures performed, audit evidence obtained, and conclusions the auditor reached (terms such as *working papers* or *workpapers* are also sometimes used). Also see **engagement documentation**.

audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence is information to which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements.

audit file. One or more folders or other storage media, in physical or electronic form, containing the records that constitute the audit documentation for a specific engagement.

audit findings (in the context of adapting GAAS to a compliance audit). The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

audit risk. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, *audit risk* is a technical term related to the process of auditing; it does not refer to the auditor's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements. Also see **detection risk** and **risk of material misstatement**.

audit risk of noncompliance (in the context of adapting GAAS to a compliance audit). The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance. Also see **detection risk of noncompliance** and **risk of material noncompliance**.

audit sampling (sampling). The selection and evaluation of less than 100 percent of the population of audit relevance such that the auditor expects the items selected (the sample) to be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population. In this context, *representative* means that evaluation of the sample will result in conclusions that, subject to the limitations of sampling risk, are similar to those that would be drawn if the same procedures were applied to the entire population.

audited financial statements. In the context of section 560, *Subsequent Events and Subsequently Discovered Facts*, reference to *audited financial statements* means the financial statements, together with the auditor's report thereon. In the context of section

810, the term *audited financial statements* refers to those financial statements audited by the auditor in accordance with GAAS and from which the summary financial statements are derived. Also see **financial statements**.

audit of internal control over financial reporting. An audit of the design and operating effectiveness of an entity's internal control over financial reporting (ICFR).

auditor. The term used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AU-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner* rather than *auditor* is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant. Also see **component auditor, engagement partner, experienced auditor, firm, predecessor auditor, service auditor,** and **user auditor**.

auditor's consent (in the context of section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*). A statement signed and dated by the auditor that indicates that the auditor consents to the use of the auditor's report, and other references to the auditor, in a registration statement filed under the Securities Act of 1933 (the 1933 Act).

auditor's external specialist. See **auditor's specialist**.

auditor's inability to obtain sufficient appropriate audit evidence. See **limitation on the scope of an audit**.

auditor's internal specialist. See **auditor's specialist**.

auditor's point estimate or **auditor's range.** An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate.

auditor's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either an auditor's internal specialist (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist. *Partner* and *firm* should be read as referring to their governmental equivalents when relevant.

In the context of section 620, *Using the Work of an Auditor's Specialist*, an individual with expertise in applying methods of accounting for deferred income tax is not a specialist because this constitutes accounting expertise; a specialist in taxation law is a specialist because this constitutes legal expertise. Also see **engagement team** and **management's specialist**.

awareness letter (in the context of section 925). A letter signed and dated by the auditor to acknowledge the auditor's awareness that the auditor's review report on unaudited interim financial information is being used in a registration statement filed under the 1933 Act. This letter is not considered to be part of the registration statement and is also commonly referred to as an *acknowledgment letter*.

basic financial statements (in the context of section 730, *Required Supplementary Information*). Financial statements presented in accordance with an applicable financial reporting framework as established by a designated accounting standards setter, excluding required supplementary information. Also see **financial statements**.

business risk. A risk resulting from significant conditions, events, circumstances, actions, or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

by-product report. An auditor's written communication that is based solely on matters identified by the auditor during the course of the audit engagement when identification of such matters is not the primary objective of the audit engagement.

capsule financial information (in the context of section 920, *Letters for Underwriters and Certain Other Requesting Parties*). Unaudited summarized interim financial information for periods subsequent to the periods covered by the audited financial statements or unaudited condensed interim financial information included in the securities offering. Capsule financial information may be presented in narrative or tabular form and is often provided for the most recent interim period and for the corresponding period of the prior year.

carve-out method. A method of reporting that excludes from the service auditor's report, when a service organization uses a subservice organization, the subservice organization's relevant control objectives and related controls in the service organization's description of its system and in the scope of the service auditor's engagement. Also see **inclusive method**.

cash basis. A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).

The cash basis of accounting is commonly referred to as an *other comprehensive basis of accounting*. In the context of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, the cash basis of accounting is not a regulatory basis of accounting. Also see **other comprehensive bases of accounting** and **special purpose framework**.

change period (in the context of section 920). The period ending on the cut-off date and ordinarily beginning, for balance sheet items, immediately after the date of the latest balance sheet in the securities offering and, for income statement items, immediately after the latest period for which such items are presented in the securities offering.

closing date (in the context of section 920). The date on which the issuer of the securities or selling security holder delivers the securities to the underwriter in exchange for the proceeds of the offering.

comfort letter (in the context of section 920). A letter issued by an auditor in accordance with section 920 to requesting parties in connection with an entity's financial statements included in a securities offering.

comparative financial statements. A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period. Also see **financial statements**.

comparative information. 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. Also see **condensed financial statements** and **summary financial statements**.

comparison date and **comparison period (in the context of section 920).** The date as of which, and period for which, data at the cut-off date and data for the change period are to be compared.

competencies and capabilities.[4] The knowledge, skills, and abilities that qualify personnel to perform an engagement covered by QM section 10A. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of QM section 10A, a measure of overall competency is qualitative rather than quantitative.

complementary user entity controls. Controls that management of the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve the control objectives stated in management's description of the service organization's system, are identified as such in that description.

completion of the engagement quality control review. The completion by the engagement quality control reviewer of the requirements in section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.[5] Also see **engagement quality control review**.

compliance audit (in the context of adapting GAAS to a compliance audit). A program-specific audit or an organization-wide audit of an entity's compliance with applicable compliance requirements.

compliance requirements (in the context of adapting GAAS to a compliance audit). Laws, regulations, rules, and provisions of contracts or grant agreements applicable to government programs with which the entity is required to comply.

component. An entity, business unit, function, or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit.

In the context of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, an investment accounted for

[4]Term defined in paragraph .A18 of QM section 10A for purposes of SQCSs.

[5]Paragraph .22 and, when applicable, compliance with paragraph .23 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

under the equity method constitutes a component. Investments accounted for under the cost method may be analogous to a component when the work and reports of other auditors constitute a major element of evidence for such investments. Also see **group** and **significant component**.

component auditor. An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team6 for a group audit.

In the context of section 600A, auditors who do not meet the definition of a member of the group engagement team are considered to be component auditors. However, an auditor who performs work on a component when the group engagement team will not use that work to provide audit evidence for the group audit is not considered a component auditor. Also see **auditor**.

component management. Management responsible for a component. Also see **management**.

component materiality. The materiality for a component determined by the group engagement team for the purposes of the group audit.

component performance materiality. An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

components of internal control. The following five components, which provide a useful framework for auditors when considering how different aspects of an entity's internal control may affect the audit:

a. The control environment

b. The entity's risk assessment process

c. The information system, including the related business processes relevant to financial reporting and communication

d. Control activities

e. Monitoring of controls

Also see **internal control**.

condensed financial statements. Historical financial information that is presented in less detail than a complete set of financial statements, in accordance with an appropriate financial reporting framework. Condensed financial statements may be separately presented as unaudited financial information or may be presented as comparative information. Also see **comparative information** and **financial statements**.

consolidation process. Reference to the *consolidation process* includes the following:

a. The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of inclusion, consolidation, proportionate consolidation, or the equity or cost methods of accounting

b. The aggregation in combined financial statements of the financial information of components that are under common control

continuing accountant (in the context of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*). An accountant who has been engaged to report on the financial statements of a specific entity or entities of which the specific entity is a component.

contractual basis. A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor. Also see **special purpose framework**.

control objective. The aim or purpose of specified controls. Control objectives address the risks that the controls are intended to mitigate. In the context of ICFR, a control objective generally relates to a relevant assertion for a significant class of transactions, account balance, or disclosure and addresses the risk that the controls in a specific area will not provide reasonable assurance that a misstatement or omission in that relevant assertion is prevented, or detected and corrected, on a timely basis.

control risk. The risk that a misstatement that could occur in an assertion about a class of transaction, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. Also see **risk of material misstatement**.

control risk of noncompliance (in the context of adapting GAAS to a compliance audit). The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance. Also see **risk of material noncompliance**.

controls. Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance. In this context

i. policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.

ii. procedures are actions to implement policies.

criteria. The benchmarks used to measure or evaluate the subject matter.

critical accounting estimates. Key assumptions and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Also may be referred to as *key sources of estimation uncertainty*. Also see **accounting estimate**.

current period. The most recent period upon which the auditor is reporting.

cut-off date (in the context of section 920). The date through which certain procedures described in the comfort letter are to relate.

date of approval of the financial statements. In some circumstances, final approval of the financial statements by governmental legislative bodies (or subsets of such legislative bodies) is required before the financial statements are issued. In these circumstances, final approval by such legislative bodies (or subsets of such legislative bodies) is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements is the earlier date on which those with the recognized authority determine that all the statements that the financial statements comprise, including the related notes, have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them. Also see **financial statements**.

date of the auditor's report. The date that the auditor dates the report on the financial statements, in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

date of the financial statements. The date of the end of the latest period covered by the financial statements. Also see **financial statements**.

deficiency in design. A deficiency in design exists when a control necessary to meet the control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. Also see **deficiency in internal control** and **deficiency in internal control over compliance**.

deficiency in internal control. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A deficiency in *design* exists when (*a*) a control necessary to meet the control objective is missing, or (*b*) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly 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. Also see **internal control**.

deficiency in internal control over compliance (in the context of adapting GAAS to a compliance audit). A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance 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 properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively. Also see **material weakness in internal control over compliance** and **significant deficiency in internal control over compliance**.

deficiency in operation. A deficiency in operation exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively. Also see **deficiency in internal control** and **deficiency in internal control over compliance**.

degree of interaction. The extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organization.

designated accounting standards setter. A body designated by the Council of the AICPA to promulgate generally accepted accounting principles (GAAP) pursuant to the "Compliance With Standards Rule" and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

detection risk. The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements. Also see **audit risk** and **risk of material misstatement**.

detection risk of noncompliance (in the context of adapting GAAS to a compliance audit). The risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material, either individually or when aggregated with other instances of noncompliance. Also see **audit risk of noncompliance** and **risk of material noncompliance**.

detective control. A control that has the objective of detecting and correcting errors or fraud that have already occurred that could result in a misstatement of the financial statements.

direct assistance. The use of internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor.

disagreements with management (in the context of section 260, *The Auditor's Communication With Those Charged With Governance*). Disagreements that do not include differences of opinion based on incomplete facts or preliminary information that are later resolved.

documentation. See **audit documentation**.

documentation completion date. The date, no later than 60 days following the report release date, on which the auditor has assembled for retention a complete and final set of documentation in an audit file.

dual purpose test. Performing a test of controls and a test of details on the same transaction. Also see **substantive procedure** and **test of controls**.

effective date (in the context of section 920). The date on which the securities offering becomes effective.

effective date of the registration statement (in the context of section 925). The date on which the registration statement filed under the 1933 Act becomes effective for purposes of evaluating the auditor's liability under Section 11 of the 1933 Act.

element of a financial statement or **element (in the context of section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*).** Reference to this term means an element, account, or item of a financial statement.

emphasis-of-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers 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. Also see **other-matter paragraph**.

engagement documentation.[6] The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*). Also see **audit documentation**.

engagement partner.[7] The partner or other individual appointed by the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed before the engagement report is released.

engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

engagement team. All partners and staff performing the audit engagement and any other individuals who perform audit procedures on the engagement, excluding an auditor's external specialist[8] and internal auditors who provide direct assistance on an engagement.[9]

entity (in the context of section 920). The party whose financial statements are the subject of the engagement.

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[6]See footnote 3.

[7]*Engagement partner*, *partner*, and *firm* refer to their governmental equivalents when relevant.

[8]See **auditor's specialist** (in the context of section 620).

[9]Section 610, *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance.

entity's risk assessment process. The entity's process for

a. identifying **business risks relevant to financial reporting objectives,**
b. estimating **the significance of the risks,**
c. assessing **the likelihood of their occurrence, and**
d. deciding **about actions to address those risks.**

estimation uncertainty. Susceptibility to an inherent lack of precision in measurement.

evidence. See **audit evidence**.

exception. A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

exempt offering document. The disclosure document that provides financial and nonfinancial information related to the entity issuing the exempt offering (or in the case of a franchise offering, the franchisor) and the offering itself.

experienced auditor. An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of

a. audit processes;
b. GAAS and applicable legal and regulatory requirements;
c. the business environment in which the entity operates; and
d. auditing and financial reporting issues relevant to the entity's industry.

Also see **auditor** and **practical audit experience**.

expertise. Skills, knowledge, and experience in a particular field.

extent of an audit procedure. Refers to the quantity of audit procedures to be performed (for example, a sample size or the number of observations of a control activity). Also see **nature of an audit procedure** and **timing of an audit procedure**.

external confirmation. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium (for example, through the auditor's direct access to information held by a third party).

external information source. An external individual or organization that provides information that is used by the entity in preparing the **financial statements** or that has been obtained by the auditor as **audit evidence**, when such information is suitable for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of **management's specialist**, **service organization**, or **auditor's specialist**, the individual or organization is not considered an external information source with respect to that particular information.

factual misstatements. Misstatements about which there is no doubt. Also see **judgmental misstatements, misstatement,** and **projected misstatements**.

fair presentation framework. See **financial reporting framework**.

financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework.

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and

a. acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

b. acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgments in *a* or *b* is not a fair presentation framework. Also see **applicable financial reporting framework, general purpose framework,** and **special purpose framework**.

financial statements. A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference when expressly permitted.

In the context of section 700, reference to *financial statements* means a complete set of general purpose financial statements, including the related notes. In the context of section 800, reference to *financial statements* means a complete set of special purpose financial statements, including the related notes. Also see **audited financial statements, basic financial statements, comparative financial statements, condensed financial statements, date of approval of the financial statements, date of the financial statements, general purpose financial statements, group financial statements, historical financial information, special purpose financial statements,** and **summary financial statements**.

firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

fraud. An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

Although fraud is a broad legal concept, the auditor is primarily concerned with fraud that causes a material misstatement in the financial statements.

fraud risk factors. Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action.

GAGAS. See ***Government Auditing Standards***.

general information technology (IT) controls. Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity's information system. Also see **IT environment**.

general purpose financial statements. Financial statements prepared in accordance with a general purpose framework.

For audits of governmental entities, the term *general purpose financial statements*, in the context of section 700, would be considered or referred to as basic financial statements using the terms in the government's applicable financial reporting framework. Also see **financial statements**.

general purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users. Also see **financial reporting framework**.

generally accepted accounting principles (GAAP). Reference to *generally accepted accounting principles* in GAAS means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" and the "Accounting Principles Rule" of the AICPA Code of Professional Conduct.

generally accepted auditing standards (GAAS). Statements on Auditing Standards issued by the ASB, the senior committee of the AICPA designated to issue pronouncements on auditing matter for nonissuers. The "Compliance With Standards Rule" of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit of a nonissuer to comply with standards promulgated by the ASB. Also see **nonissuer.**

generally accepted government auditing standards. See ***Government Auditing Standards***.

***Government Auditing Standards* .** Standards and guidance issued by the Comptroller General of the United States, U.S. Government Accountability Office for financial audits, attestation engagements, and performance audits. *Government Auditing Standards* also is known as generally accepted government auditing standards (GAGAS) or the Yellow Book.

government program (in the context of adapting GAAS to a compliance audit). The means by which governmental entities achieve their objectives. For example, one of the objectives of the U.S. Department of Agriculture is to provide nutrition to individuals in need. Examples of government programs designed to achieve that objective are the Supplemental Nutrition Assistance Program and the National School Lunch Program. Government programs that are relevant to section 935, *Compliance Audits*, are those in which a grantor or pass-through entity provides an award to another entity, usually in the form of a grant, contract, or other agreement. Not all government programs provide cash assistance; sometimes noncash assistance is provided (for example, a loan guarantee, commodities, or property).

governmental audit organization. A governmental entity, agency, or other department that is required or permitted by law or other authorization to audit other governmental entities, agencies, or departments.

governmental audit requirement (in the context of adapting GAAS to a compliance audit). A government requirement established by law, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers.

grantor (in the context of adapting GAAS to a compliance audit). A government agency from which funding for the government program originates.

group. A reporting entity for which group financial statements are prepared. Also see **component** and **significant component**.

group audit. The audit of group financial statements. Also see **initial audit engagement, reaudit,** and **recurring audit**.

group auditor. The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for the following:

i. Establishing the overall group audit strategy and group audit plan

ii. Directing and supervising component auditors and reviewing their work

iii. Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements

group audit opinion. The audit opinion on the group financial statements. Also see **modified opinion** and **unmodified opinion**.

group engagement partner. The engagement partner responsible for the group audit. Also see **engagement partner** and **partner**.

group engagement team. Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements. Also see **engagement team**.

group financial statements. Financial statements that include the financial information of more than one entity or business unit through a consolidation process.

For purposes of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, a consolidation process includes one or more of the following:

i. Consolidation, proportionate consolidation, inclusion, or an equity method of accounting

ii. The presentation in combined financial statements of the financial information of entities or business units that are under common control or common management

iii. The aggregation of the financial information of entities or business units such as branches or divisions

Also see **financial statements**.

group management. Management responsible for the preparation of the group financial statements. Also see **management**.

group performance materiality. Performance materiality in relation to the group financial statements as a whole, as determined by the group auditor. Also see **performance materiality**.

group-wide controls. Controls designed, implemented, and maintained by group management over group financial reporting.

historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. Also see **financial statements** and **interim financial information**.

hypothetical transaction (in the context of section 915). A transaction or financial reporting issue that does not involve facts or circumstances of a specific entity.

included (in the context of section 920). References to information that is included in a document are to be read to also encompass information that is incorporated by reference in that document.

included or **the inclusion of (in the context of section 925).** References to *included* or *the inclusion of* in a registration statement means included or incorporated by reference in a registration statement filed under the 1933 Act.

inclusive method. A method of reporting that includes in the service auditor's report, when a service organization uses a subservice organization, the subservice organization's relevant control objectives and related controls in the service organization's description of its system and in the scope of the service auditor's engagement. Also see **carve-out method**.

inconsistency. Other information that conflicts with information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

incorporated by reference. See **included** and **included or the inclusion of**.

independence.[10] Consists of two elements, defined as follows:

a. Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

This definition should not be interpreted as an absolute. For example, the phrase "without being affected by influences that compromise professional judgment" is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, the member should determine whether such influences, if present, create a threat that is not at an acceptable level that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement or would be perceived as not being able to do so by a reasonable and in-formed third party with knowledge of all relevant information.

information-processing controls. Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information.

inherent risk. The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. Also see **risk of material misstatement**.

inherent risk factors. Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions,

[10]Term defined in ET section 0.400, *Definitions*.

account balance, or disclosure, before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.

Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the *spectrum of inherent risk*.

inherent risk of noncompliance (in the context of adapting GAAS to a compliance audit). The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance. Also see **risk of material noncompliance**.

initial audit engagement. An engagement in which either (*a*) the financial statements for the prior period were not audited, or (*b*) the financial statements for the prior period were audited by a predecessor auditor. Also see **group audit, reaudit,** and **recurring audit**.

inputs. Refers, in some cases, to assumptions that may be made or identified by a specialist to assist management in making accounting estimates. Inputs may also refer to the underlying data to which specific assumptions are applied. Also see **observable inputs** (or equivalent) and **unobservable inputs** (or equivalent).

inspection. Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

interim financial information (in the context of section 930, *Interim Financial Information*). Financial information prepared and presented in accordance with an applicable financial reporting framework that comprises either a complete or condensed set of financial statements covering a period or periods less than one full year or covering a 12-month period ending on a date other than the entity's fiscal year end. Also see **historical financial information**.

internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes.

internal control. A process effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Also see **components of internal control** and **deficiency in internal control**.

internal control over financial reporting. A process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with the applicable financial reporting framework and includes those policies and procedures that

i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity;

ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the applicable financial reporting framework, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and

iii. provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

ICFR has inherent limitations. ICFR is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. ICFR also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented, or detected and corrected, on a timely basis by ICFR.

interpretive publications. Auditing interpretations of GAAS, auditing guidance included in AICPA Audit and Accounting Guides, exhibits to GAAS, and AICPA Auditing Statements of Position.

issuer. Section 3(a)(8) of the Securities Act of 1934 defines the term as follows:

> The term “issuer” means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term “issuer” means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term “issuer” means the person by whom the equipment or property is, or is to be, used.

Also see **nonissuer**.

IT environment. The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this definition

i. an *IT application* is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.

ii. the IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.

iii. the IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment, and manage IT operations.

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. Also see **factual misstatements, misstatement,** and **projected misstatements**.

key audit matters. Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

key sources of estimation uncertainty. See **critical accounting estimates**.

known questioned costs (in the context of adapting GAAS to a compliance audit). Questioned costs specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs. Also see **likely questioned costs**.

legal counsel (in the context of section 501, *Audit Evidence—Specific Considerations for Selected Items*). The entity's in-house legal counsel and external legal counsel.

likely questioned costs (in the context of adapting GAAS to a compliance audit). The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn. Also see **known questioned costs**.

limitation on the scope of an audit. The auditor's inability to obtain sufficient appropriate audit evidence, which may arise from the following:

a. Circumstances beyond the control of the entity

b. Circumstances relating to the nature or timing of the auditor's work

c. Limitations imposed by management

Also may be referred to as a *scope limitation*.

management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

In the context of section 210A, *Terms of Engagement*, and section 580, *Written Representations*, references to *management* are to be read as "management and, when appropriate, those charged with governance" unless the context suggests otherwise. Also see **component management, group management,** and **those charged with governance**.

management bias. A lack of neutrality by management in the preparation of information.

management's assessment about ICFR. Management's conclusion about the effectiveness of the entity's ICFR, based on suitable and available criteria. Management's assessment is included in management's report on ICFR.

management's point estimate. The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

management's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements. Also see **auditor's specialist**.

material noncompliance (in the context of adapting GAAS to a compliance audit). In the absence of a definition of *material noncompliance* in the governmental audit requirement, a failure to follow compliance requirements or a violation of prohibitions included in the applicable compliance requirements that results in noncompliance that is quantitatively or qualitatively material, either individually or when aggregated with other noncompliance, to the affected government program.

material weakness. A deficiency, or a 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 reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probably as defined as follows:

> **reasonably possible.** The chance of the future event or events occurring is more than remote but less than likely.
>
> **probable.** The future event or events are likely to occur.

material weakness in internal control over compliance (in the context of adapting GAAS to a compliance audit). A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In section 935, a reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

> **reasonably possible.** The chance of the future event or events occurring is more than remote but less than likely.
>
> **probable.** The future event or events are likely to occur.

Also see **deficiency in internal control over compliance** and **significant deficiency in internal control over compliance**.

misstatement. A difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects. Also see **factual misstatements, judgmental misstatements, projected misstatements,** and **uncorrected misstatements**.

misstatement of fact. Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

misstatement of other information. A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading.

modified opinion. A qualified opinion, an adverse opinion, or a disclaimer of opinion. Also see **group audit opinion** and **unmodified opinion**.

monitoring.[11] A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

nature of an audit procedure. Refers to the purpose (test of controls or substantive procedure) and type (inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure) of an audit procedure. Also see **extent of an audit procedure** and **timing of an audit procedure**.

negative assurance (in the context of section 920). A statement that, based on the procedures performed, nothing has come to the auditor's attention that caused the auditor to believe that specified matters do not meet specified criteria (for example, that nothing came to the auditor's attention that caused the auditor to believe that any material modifications should be made to the unaudited interim financial information for it to be in accordance with GAAP).

negative confirmation request. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Also see **positive confirmation request**.

network. As defined in "Definitions" (ET sec. 0.400) in the AICPA Code of Professional Conduct, an association of entities that includes one or more firms.

network firm. As defined in "Definitions" in the AICPA Code of Professional Conduct, a firm or other entity that belongs to a network. References to a *network firm* are to be read hereafter as "another firm or entity that belongs to the same network as the firm."

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[11]Term also defined in paragraph .13 of QM section 10A for purposes of SQCSs. Refer to QM section 10A for specific language.

noncompliance (in the context of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*). Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

nonissuer. Any entity not subject to the oversight authority of the PCAOB (that is, those entities whose audits are not within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended). Also see **generally accepted auditing standards (GAAS)** and **issuer**.

nonresponse. A failure of the confirming party to respond, or fully respond, to a positive confirmation request or a confirmation request returned undelivered.

nonroutine transactions. Transactions that are unusual, either due to size or nature, and that, therefore, occur infrequently.

nonsampling risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

nonstatistical sampling. See **statistical sampling**.

notes to financial statements. See **financial statements**.

observable. In the context of a fair value accounting estimate, the term *observable* refers to data that is readily available, such as published interest rate data or exchange-traded prices of securities.

observable inputs (or equivalent)**.** With respect to fair value accounting estimates, assumptions or inputs that reflect what market participants would use in pricing an asset or a liability, developed based on market data obtained from sources independent of the reporting entity. Also see **inputs** and **unobservable inputs** (or equivalent).

omitted procedure. An auditing procedure that the auditor considered necessary in the circumstances existing at the time of the audit of the financial statements but which was not performed.

opening balances. Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

organization-wide audit (in the context of adapting GAAS to a compliance audit). An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers. Also see **program-specific audit**.

other auditing publications. Publications other than interpretive publications; these include AICPA auditing publications not defined as interpretive publications; auditing articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instruction materials, textbooks, guide books, audit programs, and checklists; and other auditing publications from state CPA societies, other organizations, and individuals.

other basis. A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements. Also see **other comprehensive bases of accounting** and **special purpose framework**.

other comprehensive bases of accounting. The cash basis, tax basis, regulatory basis, and other basis of accounting. Also see **cash basis**, **regulatory basis**, **tax basis**, and **other basis**.

other information. Financial or nonfinancial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

other-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to 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. Also see **emphasis-of-matter paragraph**.

outcome of an accounting estimate. The actual monetary amount that results from the resolution of the transactions, events, or conditions addressed by an accounting estimate.

owner-manager. The proprietor of a smaller entity who is involved in running the entity on a day-to-day basis.

partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

pass-through entity (in the context of adapting GAAS to a compliance audit). An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

performance materiality. The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, the term *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. Also see **tolerable misstatement**.

performing initial procedures. On both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement, performing initial procedures means that the procedures are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

personnel. Partners and staff in the firm.

pervasive. A term used in the context of misstatements to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. 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.

population. The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

positive confirmation request. A request that the confirming party respond directly to the auditor by providing the requested information or indicating whether the confirming party agrees or disagrees with the information in the request. Also see **negative confirmation request**.

practicable (in the context of section 705, *Modifications to the Opinion in the Independent Auditor's Report*). The term *practicable*[12] means that omitted information is reasonably obtainable from management's accounts and records and that providing the information in the auditor's report does not require the auditor to assume the position of a preparer of financial information.

practical audit experience. Possessing the competencies and skills that would have enabled the auditor to perform the audit but does not mean that the auditor is required to have performed comparable audits. Also see **experienced auditor**.

preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise on which an audit is conducted.

predecessor auditor. The auditor from a different audit firm who has reported on the most recent audited financial statements or was engaged to perform but did not complete an audit of the financial statements. Also see **auditor**.

[12]As used in the context of paragraphs .22 and .24*c* of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted (the premise)**.** Management and, when appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with GAAS; that is, responsibility

a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;

b. for 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; and

c. to provide the auditor with

    i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;

    ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

    iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted may also be referred to as the *premise*.

prescribed guidelines. The authoritative guidelines established by the designated accounting standards setter for the methods of measurement and presentation of the required supplementary information.

presumptively mandatory requirements.[13] The category of professional requirements with which the auditor must comply in all cases in which such a requirement is relevant, except in rare circumstances discussed in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. GAAS use the word "should" to indicate a presumptively mandatory requirement. Also see **generally accepted auditing standards (GAAS)** and **unconditional requirements**.

preventive control. A control that has the objective of preventing errors or fraud that could result in a misstatement of the financial statements.

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[13]Term also defined in paragraph .08 of QM section 10A for purposes of SQCSs. Refer to QM section 10A for specific language.

private equity exchanges. Refers to entities that trade unregistered private equity securities on electronic trading platforms.

probable (in the context of adapting GAAS to a compliance audit). The future event or events are likely to occur. Also see **material weakness in internal control over compliance**.

professional judgment. The application of relevant training, knowledge, and experience, within the context provided by auditing, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, or by other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

program-specific audit (in the context of adapting GAAS to a compliance audit). An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements. Also see **organization-wide audit**.

projected misstatements. The auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Also see **factual misstatements, judgmental misstatements,** and **misstatement**.

purchase agreement. See **underwriter**.

purpose of an audit procedure. See **nature of an audit procedure**.

questioned costs (in the context of adapting GAAS to a compliance audit). Costs that are questioned by the auditor because (*a*) of a violation or possible violation of the applicable compliance requirements, (*b*) the costs are not supported by adequate documentation, or (*c*) the incurred costs appear unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

readily available. Obtainable by a third-party user without any further action by the entity (for example, financial statements on an entity's website may be considered readily available, but being available upon request is not considered readily available).

reasonable assurance.[14] In the context of an audit of financial statements, a high, but not absolute, level of assurance.

reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).

reasonably possible (in the context of adapting GAAS to a compliance audit). The chance of the future event or events occurring is more than remote but less than likely. Also see **material weakness in internal control over compliance**.

reaudit. An initial audit engagement to audit financial statements that have been previously audited by a predecessor auditor. Also see **group audit, initial audit engagement,** and **recurring audit**.

recurring audit. An audit engagement for an existing audit client for whom the auditor performed the preceding audit. Also see **group audit, initial audit engagement,** and **reaudit**.

reference to GAAP in GAAS. See **generally accepted accounting principles (GAAP)**.

referred-to auditor. An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.

regulatory basis. A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).

The regulatory basis of accounting is commonly referred to as *other comprehensive bases of accounting*. Also see **other comprehensive bases of accounting** and **special purpose framework**.

related notes. See **financial statements**.

related party. A party defined as a *related party* in GAAP.

relevant assertions. An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement. A risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude). The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (that is, the determination is based on inherent risk).

relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist

[14]See footnote 11.

of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

remote (in the context of adapting GAAS to a compliance audit). The chance of the future event or events occurring is slight. Also see **material weakness in internal control over compliance**.

report on compliance. An auditor's report on an entity's compliance with aspects of contractual agreements or regulatory requirements, insofar as they relate to accounting matters, in connection with an audit of financial statements (commonly referred to as a *by-product report*). Also see **by-product report**.

report on management's description of a service organization's system and the suitability of the design of controls (referred to in section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, as a *type 1 report*). A report that comprises the following:

a. Management's description of the service organization's system

b. A written assertion by management of the service organization about whether, in all material respects, and based on suitable criteria

   i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date

c. A service auditor's report that expresses an opinion on the matters in *b*(i–ii)

report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls (referred to in section 402 as a *type 2 report*)**.** A report that comprises the following:

a. Management's description of the service organization's system

b. A written assertion by management of the service organization about whether in all material respects and, based on suitable criteria

   i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives

iii. the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives

c. A service auditor's report that

i. expresses an opinion on the matters in *b*(i–iii)

ii. includes a description of the service auditor's tests of controls and the results thereof

report release date. The date the auditor grants the entity permission to use the auditor's report in connection with the financial statements.

reporting accountant (in the context of section 915). An accountant, other than a continuing accountant, in public practice, as described in ET section 0.400, who prepares a written report or provides oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements. (A reporting accountant who is also engaged to provide accounting and reporting advice to a specific entity on a recurring basis is commonly referred to as an *advisory accountant*.)

representative sample. See **audit sampling (sampling)**.

requesting party (in the context of section 920). One of the following specified parties requesting a comfort letter, which has negotiated an agreement with the entity:

- An underwriter
- Other parties that are conducting a review process that is, or will be, substantially consistent with the due diligence process performed when the securities offering is, or if the securities offering was, being registered pursuant to the 1933 Act, as follows:
  - — A selling shareholder, sales agent, or other party with a statutory due diligence defense under Section 11 of the 1933 Act
  - — A broker-dealer or other financial intermediary acting as principal or agent in a securities offering in connection with the following types of securities offerings:
    - Foreign offerings, including Regulation S, Eurodollar, and other offshore offerings
    - Transactions that are exempt from the registration requirements of Section 5 of the 1933 Act, including those pursuant to Regulation A, Regulation D, and Rule 144A
    - Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the 1933 Act

— The buyer or seller in connection with acquisition transactions in which there is an exchange of stock

required supplementary information. Information that a designated accounting standards setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established. Also see **supplementary information**.

response (in relation to a system of quality management). Policies or procedures designed and implemented by the firm to address one or more quality risks.

- Policies are statements of what should, or should not, be done to address a quality risk or risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- Procedures are actions to implement policies.

retrospective application. An entity's application of a change in accounting principle to one or more prior periods that were included in previously issued financial statements, as if that principle had always been used.

risk assessment procedures. The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

risk assessment process. See **entity's risk assessment process**.

risk of material misstatement. The risk that the financial statements are materially misstated prior to the audit. This consists of two components, described as follows at the assertion level:

> **inherent risk.** The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
>
> **control risk.** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Also see **audit risk** and **detection risk**.

risk of material misstatement at the overall financial statement level. Refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

risk of material noncompliance (in the context of adapting GAAS to a compliance audit). The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

> **inherent risk of noncompliance.** The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.
>
> **control risk of noncompliance.** The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

Also see **audit risk of noncompliance** and **detection risk of noncompliance**.

risks arising from the use of IT. Susceptibility of information-processing controls to ineffective design or operation, or risks to the integrity of information in the entity's information system, due to ineffective design or operation of controls in the entity's IT processes. See **IT environment**.

sampling. See **audit sampling (sampling)**.

sampling risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

a. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when, in fact, it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
b. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when, in fact, it does not. This type of erroneous conclusion affects audit efficiency because it would usually lead to additional work to establish that initial conclusions were incorrect.

sampling unit. The individual items constituting a population.

scanning. A type of analytical procedure involving the auditor's exercise of professional judgment to review accounting data to identify significant or unusual items to test. Also see **analytical procedures**.

scope limitation. See **limitation on the scope of an audit**.

securities offerings (in the context of section 920). One of the following types of securities offerings:

- Registration of securities with the SEC under the 1933 Act
- Foreign offerings, including Regulation S, Eurodollar, and other offshore offerings
- Transactions that are exempt from the registration requirements of Section 5 of the 1933 Act, including those pursuant to Regulation A, Regulation D, and Rule 144A
- Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the 1933 Act
- Acquisition transactions in which there is an exchange of stock

security. *Security* has the meaning as defined in Section 2(a)(1) of the Securities Act of 1933, as amended.

service auditor. A practitioner who reports on controls at a service organization. Also see **auditor**.

service organization. An organization or segment of an organization that provides services to user entities that are relevant to those user entities' internal control over financial reporting. Also see **subservice organization** and **user entity**.

service organization's system. The policies and procedures designed, implemented, and documented by management of the service organization to provide user entities with the services covered by the service auditor's report. Management's description of the service organization's system identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls.

significant class of transactions, account balance, or disclosure. A class of transactions, account balance, or disclosure for which there is one or more relevant assertions.

significant component. A component identified by the group engagement team (*a*) that is of individual financial significance to the group, or (*b*) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. Also see **component** and **group**.

significant deficiency. 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. Also see **material weakness**.

significant deficiency in internal control over compliance (in the context of adapting GAAS to a compliance audit). A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. Also see **deficiency in internal control over compliance** and **material weakness in internal control over compliance**.

significant risk. An identified risk of material misstatement

i. for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or

ii. that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.

significant unusual transactions. Significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature.

single financial statement or **specific element of a financial statement (in the context of section 805).** Reference to this term includes the related notes. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information relevant to the financial statement or the specific element.

smaller, less complex entity. For purposes of specifying additional considerations to audits of smaller, less complex entities, this term refers to an entity that typically possesses qualitative characteristics, such as the following:

a. Concentration of ownership and management in a small number of individuals; and

b. One or more of the following:

    i. Straightforward or uncomplicated transactions

    ii. Simple record keeping

    iii. Few lines of business and few products within business lines

    iv. Few internal controls

    v. Few levels of management with responsibility for a broad range of controls

    vi. Few personnel, many having a wide range of duties

These qualitative characteristics are not exhaustive, they are not exclusive to smaller, less complex entities, and smaller, less complex entities do not necessarily display all of these characteristics.

special purpose financial statements. Financial statements prepared in accordance with a special purpose framework. Also see **financial statements**.

special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

a. **cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).

b. **tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.

c. **regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).

d. **contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.

e. **other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*. Also see **financial reporting framework**.

specialist. See **auditor's specialist**.

specific element of a financial statement. See **single financial statement**.

specific transaction (in the context of section 915). A completed or proposed transaction or group of related transactions or a financial reporting issue involving facts and circumstances of a specific entity.

specified parties. The intended users of the auditor's written communication.

staff. Professionals, other than partners, including any specialist the firm employs.

statistical sampling. An approach to sampling that has the following characteristics:

a. Random selection of the sample items

b. The use of an appropriate statistical technique to evaluate sample results, including measurement of sampling risk

A sampling approach that does not have characteristics *a* and *b* is considered nonstatistical sampling.

stratification. The process of dividing a population into subpopulations, each of which is a group of sampling units that have similar characteristics.

subsequent events. Events occurring between the date of the financial statements and the date of the auditor's report.

subsequently discovered facts. 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.

subservice organization. A service organization used by another service organization to perform some of the services provided to user entities that are relevant to those user entities' internal control over financial reporting. Also see **service organization** and **user entity**.

substantive analytical procedures. See **analytical procedures** and **substantive procedure**.

substantive procedure. An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise

a. tests of details (classes of transactions, account balances, and disclosures) and

b. substantive analytical procedures.

Also see **analytical procedures, dual purpose test,** and **test of controls**.

successor auditor. See **auditor**.

sufficiency (of audit evidence). The measure of the quantity of audit evidence. The quantity of audit evidence necessary is affected by the auditor's assessment of the risks of material misstatement and the quality of the audit evidence obtained (that is, its appropriateness). Also see **audit evidence**.

suitably qualified external person.[15] An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

summary financial statements (in the context of section 810). Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time. Summary financial statements are separately presented and are not presented as comparative information. Also see **comparative information** and **financial statements**.

supplementary information. Information presented outside the basic financial statements, excluding required supplementary information that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements. Also see **required supplementary information**.

[15]See footnote 11.

system of internal control. The system designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For purposes of GAAS, the system of internal control consists of five interrelated components:

i. Control environment

ii. The entity's risk assessment process

iii. The entity's process to monitor the system of internal control

iv. The information system and communication

v. Control activities

tax basis. A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.

The *tax basis* of accounting is commonly referred to as an *other comprehensive basis of accounting*. In the context of section 800, the tax basis of accounting is not a regulatory basis of accounting. Also see **other comprehensive bases of accounting** and **special purpose framework**.

test of controls. An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. Also see **dual purpose test** and **substantive procedure**.

those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager. Also see **management**.

threatened legal proceeding. A potential claimant has manifested to the auditor an awareness of, and a present intention to assert, a possible claim.

timing of an audit procedure. Refers to when an audit procedure is performed or the period or date to which the audit evidence applies. Also see **extent of an audit procedure** and **nature of an audit procedure**.

tolerable misstatement. A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

Tolerable misstatement is also the application of performance materiality to a particular sampling procedure. Also see **performance materiality**.

tolerable rate of deviation. A rate of deviation set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

type 1 report. See **report on management's description of a service organization's system and the suitability of the design of controls**.

type 2 report. See **report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls**.

type of an audit procedure. See **nature of an audit procedure**.

unconditional requirements.[16] The category of professional requirements with which the auditor must comply in all cases in which such a requirement is relevant. GAAS use the word "must" to indicate an unconditional requirement. Also see **generally accepted auditing standards (GAAS)** and **presumptively mandatory requirements**.

uncorrected misstatements. Misstatements that the auditor has accumulated during the audit and that have not been corrected. Also see **misstatement**.

understanding of the entity. Obtaining an understanding of the entity and its environment, including the entity's internal control.

underwriter (in the context of section 920). As defined in the 1933 Act

> any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph, the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Except when the context otherwise requires, the word *underwriter* as used in section 920, refers to the managing, or lead, underwriter, who typically negotiates the underwriting agreement or purchase agreement (hereafter referred to as the *underwriting agreement*) for a group of underwriters whose exact composition is not determined until shortly before a securities offering becomes effective.

underwriting agreement. See **underwriter**.

unmodified opinion. The opinion expressed by the auditor when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance

[16]See footnote 13.

with the applicable financial reporting framework. Also see **group audit opinion** and **modified opinion**.

unobservable inputs (or equivalent)**.** With respect to fair value accounting estimates, assumptions or inputs that reflect the entity's own judgments about what assumptions market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances. Also see **inputs** and **observable inputs** (or equivalent).

user auditor. An auditor who audits and reports on the financial statements of a user entity. Also see **auditor**.

user entity. An entity that uses a service organization and whose financial statements are being audited. Also see **service organization** and **subservice organization**.

working papers or **workpapers.** See **audit documentation** and **engagement documentation**.

written report (in the context of section 915). Any written communication that provides a conclusion on the appropriate application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements.

written representation. A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

Yellow Book. See ***Government Auditing Standards***.

AU-C Sections 200–299

GENERAL PRINCIPLES AND RESPONSIBILITIES

The following is a Codification of Statements on Auditing Standards (SASs) resulting from the Clarification and Convergence Project of the Auditing Standards Board (ASB), and related Auditing Interpretations. SASs are issued by the ASB, the senior committee of the AICPA designated to issue pronouncements on auditing matters. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires adherence to the applicable generally accepted auditing standards (GAAS) promulgated by the ASB. An auditor is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. An auditor is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, an auditor may depart from a presumptively mandatory requirement provided the auditor documents justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement.

Auditing interpretations of GAAS are *interpretive publications*, as defined in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit. Interpretive publications are not auditing standards. Interpretive publications are recommendations on the application of GAAS in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. Auditing interpretations of GAAS are included in AU-C sections. AICPA Audit and Accounting Guides and Auditing Statements of Position are listed in AU-C appendix D, *AICPA Audit and Accounting Guides and Statements of Position*.

AU-C Section 200

Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

Source: SAS No. 122; SAS No. 123; SAS No. 128; SAS No. 130; SAS No. 134; SAS No. 136; SAS No. 138; SAS No. 142; SAS No. 143; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with generally accepted auditing standards (GAAS). Specifically, it sets out the overall objectives of the independent auditor (the auditor) and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority, and structure of GAAS and includes requirements establishing the general responsibilities of the auditor applicable in all engagements conducted in accordance with GAAS, including the obligation to comply with GAAS. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.02 GAAS are developed and issued in the form of Statements on Auditing Standards (SASs) and are codified into AU-C sections. GAAS are written in the context of an audit of financial statements by an auditor. They are to be adapted as necessary in the circumstances when applied to other engagements conducted in accordance with GAAS, such as audits of other historical financial information, compliance audits, and audits of internal control over financial reporting that are integrated with audits of financial statements. GAAS do not address the responsibilities of the auditor that may exist in legislation, regulation, or otherwise, in connection with, for example, the offering of securities to the public. Such responsibilities may differ from those established in GAAS. Accordingly, although the auditor may find aspects of GAAS helpful in such circumstances, it is the responsibility of the auditor to ensure compliance with all relevant legal, regulatory, or professional obligations. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Association With Financial Statements

.03 An auditor is associated with financial information when the auditor has applied procedures sufficient to permit the auditor to report in accordance with GAAS. Statements on Standards for Accounting and Review Services address the accountant's considerations when the accountant prepares and presents financial statements to the entity or to third parties.

An Audit of Financial Statements

.04 The purpose of an audit is to provide financial statement users with an opinion by the auditor on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework, which enhances the degree of confidence that intended users can place in the financial statements. An audit conducted in accordance with GAAS and relevant ethical requirements enables the auditor to form that opinion. (Ref: par. .A1)

.05 The financial statements subject to audit are those of the entity, prepared and presented by management of the entity with oversight from those charged with governance. GAAS do not impose responsibilities on management or those charged with governance and do not override laws and regulations that govern their responsibilities. However, an audit in accordance with GAAS is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: par. .A2–.A13)

.06 As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (Ref: par. .A34–.A59)

.07 The concept of materiality is applied by the auditor when both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and uncorrected misstatements, if any, on the financial statements.[1] In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements. Judgments about materiality are made in light of surrounding circumstances, and involve both qualitative and quantitative considerations. These judgments are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or both. The auditor's opinion addresses the financial statements as a whole. Therefore, the auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by fraud or error, that are not material to the financial statements as a whole, are detected. (Ref: par. .A14) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.08 GAAS contain objectives, requirements, and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. GAAS require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things,

- identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control.
- obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- form an opinion on the financial statements, or determine that an opinion cannot be formed, based on an evaluation of the audit evidence obtained.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.09 The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation.

.10 The auditor also may have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, regarding matters arising from the audit. These responsibilities may be established by GAAS or by applicable law or regulation.[2]

[1] See section 320, *Materiality in Planning and Performing an Audit*, and section 450, *Evaluation of Misstatements Identified During the Audit*.

Effective Date

.11 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Overall Objectives of the Auditor

.12 The overall objectives of the auditor, in conducting an audit of financial statements, are to

a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and

b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings.

.13 In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, GAAS require that the auditor disclaim an opinion or withdraw from the engagement, when withdrawal is possible under applicable law or regulation.

Definitions

.14 For purposes of GAAS, the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Audit risk. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Auditor. The term used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AU-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner* rather than *auditor* is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

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[2] For examples, see section 260, *The Auditor's Communication With Those Charged With Governance*; section 265, *Communicating Internal Control Related Matters Identified in an Audit*; and paragraph .42 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

Detection risk. The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, U.S. generally accepted accounting principles, International Financial Reporting Standards (IFRSs) promulgated by the International Accounting Standards Board (IASB), or a special purpose framework.[3]

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and

a. acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

b. acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgments in (*a*) or (*b*) is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time, in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference when expressly permitted.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Interpretive publications. Auditing interpretations of GAAS, exhibits to GAAS, auditing guidance included in AICPA Audit and Accounting Guides, and AICPA Auditing Statements of Position (SOP).

[3] See section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Other auditing publications. Publications other than interpretive publications; these include AICPA auditing publications not defined as interpretive publications; auditing articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instruction materials, textbooks, guide books, audit programs, and checklists; and other auditing publications from state CPA societies, other organizations, and individuals.

Premise relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted, (the premise)**.** Management and, when appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with GAAS; that is, responsibility

a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;

b. for 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; and

c. to provide the auditor with

   i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;

   ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

   iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The *premise, relating to the responsibilities of management and, when appropriate, those charged with governance, on which an audit is conducted* may also be referred to as the *premise.*

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by auditing, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

Reasonable assurance. In the context of an audit of financial statements, a high, but not absolute, level of assurance.

Risk of material misstatement. The risk that the financial statements are materially misstated prior to the audit. This consists of two components, described as follows at the assertion level: (Ref. par. .A15)

> **Inherent risk.** The susceptibility of an assertion about a class of transaction, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
>
> **Control risk.** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

.15 The auditor must be independent of the entity when performing an engagement in accordance with GAAS unless (*a*) GAAS provides otherwise or (*b*) the auditor is required by law or regulation to accept the engagement and report on the financial statements. When the auditor is not independent and neither (*a*) nor (*b*) are applicable, the auditor is precluded from issuing a report under GAAS.

.16 The auditor should comply with relevant ethical requirements relating to financial statement audit engagements. (Ref: par. .A16–.A22)

Professional Skepticism

.17 The auditor should plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: par. .A23–.A27)

Professional Judgment

.18 The auditor should exercise professional judgment in planning and performing an audit of financial statements. (Ref: par. .A29–.A33)

Sufficient Appropriate Audit Evidence and Audit Risk

.19 To obtain reasonable assurance, the auditor should obtain sufficient appropriate audit evidence[4] to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: par. .A34–.A59)

Conduct of an Audit in Accordance With GAAS

Complying With AU-C Sections Relevant to the Audit

.20 The auditor should comply with all AU-C sections relevant to the audit. An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist. (Ref: par. .A60–.A65)

.21 The auditor should have an understanding of the entire text of an AU-C section, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: par. .A66–.A76)

.22 The auditor should not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of this section and all other AU-C sections relevant to the audit.

Objectives Stated in Individual AU-C Sections

.23 To achieve the overall objectives of the auditor, the auditor should use the objectives stated in individual AU-C sections in planning and performing the audit considering the interrelationships within GAAS to (Ref: par. .A77–.A79)

a. determine whether any audit procedures in addition to those required by individual AU-C sections are necessary in pursuance of the objectives stated in each AU-C section; and (Ref: par. .A80)

b. evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: par. .A81)

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[4] See paragraph .06 of section 500, *Audit Evidence*, for the definition of *audit evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Complying With Relevant Requirements

.24 Subject to paragraph .26, the auditor should comply with each requirement of an AU-C section unless, in the circumstances of the audit,

a. the entire AU-C section is not relevant; or

b. the requirement is not relevant because it is conditional and the condition does not exist. (Ref: par. .A82–.A83)

Defining Professional Responsibilities in GAAS

.25 GAAS use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility it imposes on auditors:

- Unconditional requirements. The auditor must comply with an unconditional requirement in all cases in which such requirement is relevant. GAAS use the word "must" to indicate an unconditional requirement.
- Presumptively mandatory requirements. The auditor must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant except in rare circumstances discussed in paragraph .26. GAAS use the word "should" to indicate a presumptively mandatory requirement. (Ref: par. .A84)

.26 In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the auditor should perform alternative audit procedures to achieve the intent of that requirement. The need for the auditor to depart from a relevant presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the intent of the requirement. (Ref: par. .A85)

Interpretive Publications

.27 The auditor should consider applicable interpretive publications in planning and performing the audit. (Ref: par. .A86)

Other Auditing Publications

.28 In applying the auditing guidance included in an other auditing publication, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. (Ref: par. .A87–.A89)

Failure to Achieve an Objective

.29 If an objective in a relevant AU-C section cannot be achieved, the auditor should evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with GAAS, to modify the auditor's opinion or withdraw from the engagement (when withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant finding or issue requiring documentation in accordance with section 230, *Audit Documentation*.[5] (Ref: par. .A90–.A91)

Application and Other Explanatory Material

An Audit of Financial Statements

Scope of the Audit (Ref: par. .04)

.A1 The auditor's opinion on the financial statements addresses whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion, therefore, does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some circumstances, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control. Although GAAS include requirements and regarding such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

Preparation and Fair Presentation of the Financial Statements (Ref: par. .05)

.A2 An audit in accordance with GAAS is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged and understand that they have responsibility

a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;

b. for 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; and

c. to provide the auditor with

    i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;

    ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

[5]Paragraph .08*c* of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

.A3 The preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance require

- the identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- the preparation and fair presentation of the financial statements in accordance with that framework.
- the inclusion of an adequate description of that framework in the financial statements.

The preparation and fair presentation of the financial statements require management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as in selecting and applying appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

.A4 The auditor may make suggestions about the form or content of the financial statements, or assist management by preparing them, in whole or in part, based on information provided to the auditor by management during the performance of the audit.[a] However, the auditor's responsibility for the audited financial statements is confined to the expression of the auditor's opinion on them. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3.]

.A5 The financial statements may be prepared in accordance with the following:

- A general purpose framework (a financial reporting framework designed to meet the common financial information needs of a wide range of users); or
- A special purpose framework (a financial reporting framework, other than generally accepted accounting principles, which is a cash, tax, regulatory, contractual basis of accounting, or other basis of accounting; an other basis of accounting uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements).

[Revised, July 2013, to reflect conforming changes necessary due to the issuance of SAS No. 127.]

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[a] In January 2013, the Professional Ethics Executive Committee adopted a provision in the "Scope and Applicability of Nonattest Services" interpretation (ET sec. 1.295.010) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. This provision provides, among other things, that financial statement preparation is considered outside the scope of the attest engagement and, therefore, constitutes a nonattest service subject to the requirements of the "Nonattest Services" subtopic (ET sec. 1.295). The provision is effective for engagements covering periods beginning on or after December 15, 2014. [Footnote added, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A6 The applicable financial reporting framework often encompasses financial accounting standards promulgated by an authorized or recognized standards-setting organization, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial accounting standards promulgated by an authorized or recognized standards-setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources, or may even consist only of such sources. Such other sources may include the following:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations regarding accounting matters;
- Published accounting interpretations of varying authority issued by standards-setting, professional, or regulatory organizations;
- Published views of varying authority on emerging accounting issues issued by standards-setting, professional, or regulatory organizations;
- General and industry practices widely recognized and prevalent; and
- Accounting literature.

When conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained, or among the sources that encompass the financial reporting framework, the source with the highest authority prevails.

.A7 The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

.A8 The financial accounting standards promulgated by organizations that are authorized or recognized to promulgate standards to be used by entities for preparing financial statements in accordance with a general purpose framework include Financial Accounting Standards Board (FASB) *Accounting Standards Codification*, issued by FASB; IFRSs, issued by the IASB; Statements of Federal Financial Accounting Standards, issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities; and Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities.

.A9 The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

- Balance sheet
- Statement of income or statement of operations
- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owners' equity
- Statement of revenue and expenses
- Statement of operations by product lines

.A10 Section 210A, *Terms of Engagement*, establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework.[6] Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses engagements in which the auditor issues a report in connection with financial statements prepared in accordance with a special purpose framework.

.A11 Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain the agreement of management and, when appropriate, those charged with governance, that they acknowledge and understand that they have the responsibilities set out in paragraph .A2 as a precondition for accepting the audit engagement.[7]

Considerations Specific to Audits of Governmental Entities

.A12 The requirements for audits of the financial statements of governmental entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a governmental entity is conducted, may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation, or other authority. (See paragraph .A66.)

.A13 In audits of governmental entities, auditors may have a responsibility under law, regulation, contract, or grant agreement to report to third parties, such as funding agencies or oversight bodies.

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[6]Paragraph .06*a* of section 210A, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[7] Paragraph .06*b* of section 210A. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

Materiality (Ref: par. .07)

Considerations Specific to Audits of Governmental Entities

.A14 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units, and therefore requires the presentation of financial statements for its activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. Generally, the auditor expresses or disclaims an opinion on a government's financial statements as a whole by expressing an opinion or disclaiming an opinion on each opinion unit. In this context, the auditor is responsible for the detection of misstatements that are material to an opinion unit within a governmental entity, but is not responsible for the detection of misstatements that are not material to an opinion unit.

Definitions

Risk of Material Misstatement

.A15 For purposes of GAAS, a risk of material misstatement exists when

a. there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and

b. if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Ethical Requirements Relating to an Audit of Financial Statements (Ref: par. .16)

.A16 The auditor is subject to relevant ethical requirements relating to financial statement audit engagements. Ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A17 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care

- Scope and nature of services

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A18 In the case of an audit engagement, it is in the public interest and, therefore, required by this section, that the auditor be independent of the entity subject to the audit. The concept of independence refers to both independence in fact and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective, and to maintain an attitude of professional skepticism. Independence implies an impartiality that recognizes an obligation to be fair not only to management and those charged with governance of an entity but also users of the financial statements who may rely upon the independent auditor's report. Guidance on threats to independence is set forth in the AICPA's "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A19 When the auditor is not independent but is required by law or regulation to report on the financial statements, section 705, *Modifications to the Opinion in the Independent Auditor's Report*, applies. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A20 Due care requires the auditor to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the audit and enable an appropriate auditor's report to be issued. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A21 QM section 10A, *A Firm's System of Quality Control*, sets out the firm's responsibilities to establish and maintain its system of quality control for audit engagements, and to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.[8] Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, addresses the engagement partner's responsibilities regarding relevant ethical requirements. These include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team, determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.[9] Section 220A recognizes that the engagement team is entitled to rely on a firm's system of quality

[8] Paragraphs .21–.25 of QM section 10A, *A Firm's System of Quality Control*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[9] Paragraphs .11–.13 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Audits of Governmental Entities

.A22 In addition to the AICPA Code of Professional Conduct and GAAS, *Government Auditing Standards*, which may be required by law, regulation, contract, or grant agreement in audits of governmental entities and entities that receive government awards, set forth relevant ethical principles and auditing standards, including standards on auditor independence, professional judgment, competence, and audit quality control and assurance. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Professional Skepticism (Ref: par. .17)

.A23 Professional skepticism includes being alert to the following, for example,

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by GAAS.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A24 Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of

- overlooking unusual circumstances.
- over-generalizing when drawing conclusions from audit observations.
- using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A25 Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in light of the circumstances; for example, in the case when fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A26 The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.[10] In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), GAAS require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.[11] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A27 The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A28 Unconscious or conscious auditor biases may affect the auditor's professional skepticism and professional judgment, including, for example, in the design and performance of audit procedures or the evaluation of audit evidence. Examples of unconscious auditor biases that may impede the maintenance of professional skepticism and, therefore, the reasonableness of the professional judgments made by the auditor in complying with the requirements of this section, may include the following:

- *Availability bias*, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- *Confirmation bias*, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief
- *Overconfidence bias*, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions
- *Anchoring bias*, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed
- *Automation bias*, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[10] Paragraphs .07–.09 of section 500, *Audit Evidence*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[11] Paragraph .10 of section 500 and paragraphs .10–.11 and .16 of section 505, *External Confirmations*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

Professional Judgment (Ref: par. .18)

.A29 Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and GAAS and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. In particular, professional judgment is necessary regarding decisions about the following:

- Materiality and audit risk
- The nature, timing, and extent of audit procedures used to meet the requirements of GAAS and gather audit evidence
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of GAAS and thereby, the overall objectives of the auditor
- The evaluation of management's judgments in applying the entity's applicable financial reporting framework
- The drawing of conclusions based on the audit evidence obtained; for example, assessing the reasonableness of the estimates made by management in preparing the financial statements

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A30 The distinguishing feature of professional judgment expected of an auditor is that such judgment is exercised based on competencies necessary to achieve reasonable judgments, developed by the auditor through relevant training, knowledge, and experience. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A31 The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as those required by section 220A, assists the auditor in making informed and reasonable judgments.[12] [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A32 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing standards and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[12] Paragraph .20 of section 220A. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

.A33 Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant findings or issues arising during the audit.[13] Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or by sufficient appropriate audit evidence. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: par. .19)

Sufficiency and Appropriateness of Audit Evidence

.A34 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[14]) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by a specialist employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and, therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A35 The sufficiency and appropriateness of audit evidence are interrelated. *Sufficiency* is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A36 *Appropriateness* is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

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[13] Paragraph .08 of section 230. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[14] Paragraph .10 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A37 Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby to enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. Section 500, *Audit Evidence*, and other relevant AU-C sections, establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Audit Risk

.A38 Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A39 For purposes of GAAS, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Risks of Material Misstatement

.A40 The risks of material misstatement exist at two levels:

- The overall financial statement level
- The assertion level for classes of transactions, account balances, and disclosures

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A41 Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A42 Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A43 The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A44 Inherent risk is influenced by inherent risk factors. Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances, and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement. For example, account balances consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level may be higher because of the high estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A45 Control risk is a function of the effectiveness of the design, implementation, and maintenance of controls by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation and fair presentation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. GAAS provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures to be performed.[15] [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A46 The assessment of the risks of material misstatement may be expressed in quantitative terms, such as percentages or nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. GAAS typically refer to the risks of material misstatement, rather than inherent risk and control risk separately. However, SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,[16] requires inherent risk to be assessed separately from control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, for accounting estimates at the relevant assertion level in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.[17,18] [Paragraph renumbered by the issuance of SAS No. 142, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A47 Risks of material misstatement are assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.[19] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A48 Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Detection Risk

.A49 For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[15] Paragraph .08 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 142, July 2020.]

[16][Footnote deleted by the issuance of SAS No. 145, October 2021.]

[17]Paragraph .07*b* of section 330. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

[18]Paragraphs A227–A239 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, address assessing risk, and paragraphs A248–A252 of SAS No. 145 address assessing control risk. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[19]Paragraph .06 of AU-C section 330. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A50 Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. The following matters assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results:

- Adequate planning
- Proper assignment of personnel to the engagement team
- The application of professional skepticism
- Supervision and review of the audit work performed

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A51 Section 300, *Planning an Audit*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Inherent Limitations of an Audit

.A52 The auditor is not expected to, and cannot, reduce audit risk to zero and cannot, therefore, obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because inherent limitations of an audit exist, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The principal inherent limitations of an audit arise from

- the nature of financial reporting;
- the nature of audit procedures; and
- the need for the audit to be conducted within a reasonable period of time and so as to achieve a balance between benefit and cost.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

The Nature of Financial Reporting

.A53 The preparation and fair presentation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and a range exists of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability that cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates that are dependent on predictions of future events. Nevertheless, GAAS require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and to related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.[20] [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

The Nature of Audit Procedures

.A54 There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and fair presentation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.
- Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation that may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Timeliness of Financial Reporting and the Balance Between Benefit and Cost

.A55 The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied

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[20]See section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, and section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, FASB's Statements of Financial Accounting Concepts). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and so as to achieve a balance between benefit and cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is fraudulent or erroneous until proved otherwise. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A56 Consequently, it is necessary for the auditor to

- plan the audit so that it will be performed in an effective manner;
- direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- use testing and other means of examining populations for misstatements.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A57 In light of the approaches described in paragraph .A56, GAAS contain requirements for the planning and performance of the audit and requires the auditor, among other things, to

- have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;[21] and
- use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.[22]

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[21] See section 315. [Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[22] See section 330, section 500, section 520, *Analytical Procedures*, and section 530, *Audit Sampling*. [Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Other Matters That Affect the Inherent Limitations of an Audit

.A58 In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include the following:

- Fraud, particularly fraud involving senior management or collusion. See section 240, *Consideration of Fraud in a Financial Statement Audit*, for further discussion.
- The existence and completeness of related party relationships and transactions. See section 550, *Related Parties*, for further discussion.
- The occurrence of noncompliance with laws and regulations. See section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Relevant AU-C sections identify specific audit procedures to assist in lessening the effect of the inherent limitations. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A59 Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with GAAS is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof, and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Conduct of an Audit in Accordance With GAAS

Nature of GAAS (Ref: par. .20)

.A60 The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit to comply with standards promulgated by the Auditing Standards Board (ASB). The ASB develops and issues standards in the form of SASs through a process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote. The

SASs are codified in AU-C sections. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A61 GAAS provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. GAAS address the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A62 The scope, effective date, and any specific limitation of the applicability of a specific AU-C section are made clear in the AU-C section. Unless otherwise stated in the AU-C section, the auditor is permitted to apply an AU-C section before the effective date specified therein. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A63 In certain audit engagements, the auditor also may be required to comply with other auditing requirements in addition to GAAS. GAAS do not override law or regulation that governs an audit of financial statements. In the event that such law or regulation differs from GAAS, an audit conducted only in accordance with law or regulation will not necessarily comply with GAAS. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A64 The auditor may also conduct the audit in accordance with both GAAS and

- auditing standards promulgated by the Public Company Accounting Oversight Board,
- International Standards on Auditing,
- *Government Auditing Standards*, or
- auditing standards of a specific jurisdiction or country.

In such cases, in addition to complying with each of the AU-C sections relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the other auditing standards. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Audits of Governmental Entities

.A65 GAAS are relevant to financial statement audits of governmental entities. The auditor's responsibilities, however, may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with GAAS. These additional responsibilities are not addressed in GAAS. *Government Auditing Standards* are relevant for engagements to audit U.S. government entities, and when required by law, regulation, contract, or grant agreement. The appendix to *Government Auditing Standards* includes a listing of some of the laws, regulations, and guidelines that require use of *Government Auditing Standards*. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Contents of GAAS (Ref: par. .21)

.A66 In addition to objectives and requirements, an AU-C section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the AU-C section and definitions. The entire text of an AU-C section, therefore, is relevant to an understanding of the objectives stated in an AU-C section and the proper application of the requirements of an AU-C section. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A67 When necessary, the application and other explanatory material provides further explanation of the requirements of an AU-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover, including, in some AU-C sections, such as section 315 [SAS No. 145], why a procedure is required.
- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section. The auditor is required by paragraph .21 to understand the application and other explanatory material; how the auditor applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AU-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AU-C section. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered and amended, effective for audits of financial statements for peri-ods ending on or after December 15, 2023, by SAS No. 145.]

.A68 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AU-C section or within the title and introduction of the appendix itself. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A69 Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AU-C section, including how the AU-C section relates to other AU-C sections.

- The subject matter of the AU-C section.
- The respective responsibilities of the auditor and others regarding the subject matter of the AU-C section.
- The context in which the AU-C section is set.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A70 An AU-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of GAAS. These are provided to assist in the consistent application and interpretation of GAAS, and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout GAAS. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A71 When appropriate, additional considerations specific to audits of smaller, less complex entities and governmental entities are included within the application and other explanatory material of an AU-C section. These additional considerations assist in the application of the requirements of GAAS in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of GAAS. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Scalability Considerations

.A72 Scalability considerations have been included in some AU-C sections (for example, section 315 [SAS No. 145]) to illustrate the application of the requirements to all entities, regardless of whether their nature and circumstances are less complex or more complex. Less complex entities are entities for which the characteristics in paragraph .A77 apply. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A73 For purposes of specifying additional considerations to audits of smaller, less complex entities, a *smaller, less complex entity* refers to an entity that typically possesses qualitative characteristics, such as the following:

a. Concentration of ownership and management in a small number of individuals; and
b. One or more of the following:
    i. Straightforward or uncomplicated transactions
    ii. Simple record keeping
    iii. Few lines of business and few products within business lines
    iv. Simpler systems of internal controls

v. Few levels of management with responsibility for a broad range of controls

vi. Few personnel, many having a wide range of duties

These qualitative characteristics are not exhaustive, they are not exclusive to smaller, less complex entities, and smaller, less complex entities do not necessarily display all of these characteristics. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Considerations Specific to Automated Tools and Techniques

.A74 The considerations specific to "automated tools and techniques" included in some AU-C sections (for example, section 315 [SAS No. 145]) have been developed to explain how the auditor may apply certain requirements when using automated tools and techniques in performing audit procedures. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A75 GAAS refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the *owner-manager*. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Governmental Entities

.A76 Considerations specific to governmental entities may also be applicable to nongovernmental entities that receive government awards. In audits of governmental entities, the considerations specific to audits of smaller, less complex entities may not apply, even if the governmental entity has few employees, simple operations, or a relatively small budget, because small governmental entities (1) may have complex transactions with federal and state governments, (2) are required to comply with laws, regulations, policies, and systems determined by a higher level of government, and (3) are subject to additional public expectations of accountability and transparency. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Objectives Stated in Individual AU-C Sections (Ref: par. .23)

.A77 Each AU-C section contains one or more objectives that provide a link between the requirements and the overall objectives of the auditor. The objectives in individual AU-C sections serve to focus the auditor on the desired outcome of the AU-C section, while being specific enough to assist the auditor in

- understanding what needs to be accomplished and, when necessary, the appropriate means of doing so; and
- deciding whether more needs to be done to achieve the objectives in the particular circumstances of the audit.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A78 Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph .12. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A79 In using the objectives, the auditor is required to consider the interrelationships among the AU-C sections. This is because, as indicated in paragraph .A61, the AU-C sections in some cases address general responsibilities and in others address the application of those responsibilities to specific topics. For example, this section requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each AU-C section. At a more detailed level, section 315 and section 330 contain, among other things, objectives and requirements that address the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An AU-C section addressing specific aspects of the audit may expand on how the objectives and requirements of other AU-C sections are to be applied regarding the subject of that AU-C section, but does not repeat those objectives and requirements. For example, section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures*, expands on how the objectives and requirements of section 315 and section 330 are to be applied regarding the subject of section 540, but section 540 does not repeat those objectives and requirements. Thus, in achieving the objective stated in section 540, the auditor considers the objectives and requirements of other relevant AU-C sections. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

*Use of Objectives to Determine Need for Additional Audit Procedures (Ref: par. .23*a*)*

.A80 The requirements of GAAS are designed to enable the auditor to achieve the objectives specified in GAAS, and thereby the overall objectives of the auditor. The proper application of the requirements of GAAS by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in GAAS, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of GAAS and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by GAAS to meet the objectives specified in GAAS. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

*Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: par. .23*b*)*

.A81 The auditor is required by paragraph .23*b* to use the objectives stated in the relevant AU-C sections to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If, as a result, the auditor concludes that sufficient appropriate audit evidence has not been obtained, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph .23*b*:

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other AU-C sections, in particular, section 330
- Extend the work performed in applying one or more requirements
- Perform other procedures judged by the auditor to be necessary in the circumstances

When none of the preceding is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by GAAS to determine the effect on the auditor's report or on the auditor's ability to complete the engagement. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Complying With Relevant Requirements

Relevant Requirements (Ref: par. .24)

.A82 In some cases, an AU-C section (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in section 610, *Using the Work of Internal Auditors*, is relevant. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A83 Within a relevant AU-C section, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope[23] represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies and material weaknesses in internal control identified during the audit to management and those charged with governance,[24] which depends on the existence and identification of such deficiencies, represents an implicit conditional requirement.

In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the auditor may be required to withdraw from the audit

[23]See section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

engagement, when withdrawal is possible under applicable law or regulation, or the auditor may be required to perform a certain action, unless prohibited by law or regulation. Depending on the jurisdiction, the legal or regulatory permission or prohibition may be explicit or implicit. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Presumptively Mandatory Requirements (Ref: par. .25)

.A84 If an AU-C section provides that a procedure or action is one that the auditor *should consider*, consideration of the procedure or action is presumptively required. Whether the auditor performs the procedure or action is based upon the outcome of the auditor's consideration and the auditor's professional judgment. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Departure From a Requirement (Ref: par. .26)

.A85 Section 230 establishes documentation requirements in those exceptional circumstances when the auditor departs from a relevant requirement.[25] GAAS do not call for compliance with a requirement that is not relevant in the circumstances of the audit. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Interpretive Publications (Ref: par. .27)

.A86 Interpretive publications are not auditing standards. *Interpretive publications* are recommendations on the application of GAAS in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. Auditing interpretations of GAAS are included in AU-C sections. AICPA Audit and Accounting Guides and auditing SOPs are listed in AU-C appendix D, *AICPA Audit and Accounting Guides and Statements of Position*. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Other Auditing Publications (Ref: par. .28)

.A87 Other auditing publications have no authoritative status; however, they may help the auditor understand and apply GAAS. The auditor is not expected to be aware of the full body of other auditing publications. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[24]Paragraph .11 of section 265. [Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[25]Paragraph .13 of section 230. [Footnote renumbered by the issuance of SAS No. 142, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 143, July 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A88 Although the auditor determines the relevance of these publications in accordance with paragraph .28, the auditor may presume that other auditing publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other auditing publications are listed in AU-C appendix F, *Other Auditing Publications*. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A89 In determining whether an other auditing publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the audit, the auditor may consider the degree to which the publication is recognized as being helpful in understanding and applying GAAS and the degree to which the publisher or author is recognized as an authority in auditing matters. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Failure to Achieve an Objective (Ref: par. .29)

.A90 Whether an objective has been achieved is a matter for the auditor's professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of GAAS, and the auditor's evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in GAAS. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that

- prevent the auditor from complying with the relevant requirements of an AU-C section.
- result in it not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph .23; for example, due to a limitation in the available audit evidence.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A91 Audit documentation that meets the requirements of section 230 and the specific documentation requirements of other relevant AU-C sections provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. Although it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

AU-C Section 210

Terms of Engagement

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 138; SAS No. 145; SAS No. 147.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note
In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities in agreeing upon the terms of the audit engagement with management and, when appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, for which management and, when appropriate, those charged with governance are responsible, are present. Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, addresses those aspects of engagement acceptance that are within the control of the auditor. (Ref: par. .A1)

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to accept an audit engagement for a new or existing audit client only when the basis upon which it is to be performed has been agreed upon through

a. establishing whether the preconditions for an audit are present and

b. confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.

Definitions

.04 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

Preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise[1] on which an audit is conducted.

Recurring audit. An audit engagement for an existing audit client for whom the auditor performed the preceding audit.

.05 For purposes of this section, references to *management* are to be read hereafter as "management and, when appropriate, those charged with governance" unless the context suggests otherwise.

Requirements

Preconditions for an Audit

.06 In order to establish whether the preconditions for an audit are present, the auditor should

a. determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable and (Ref: par. .A2–.A8)

b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A9–.A12 and .A18)

   i. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; (Ref: par. .A13)

   ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are

[1] Paragraphs .05 and .A2 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

free from material misstatement, whether due to fraud or error; and (Ref: par. .A14–.A16)

iii. to provide the auditor with

1. access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;

2. additional information that the auditor may request from management for the purpose of the audit; and (Ref: par. .A17)

3. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion

.07 If management or those charged with governance of an entity that is not required by law or regulation to have an audit impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement, such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements as a whole, the auditor should not accept such a limited engagement as an audit engagement. If management or those charged with governance of an entity that is required by law or regulation to have an audit imposes such a scope limitation and a disclaimer of opinion is acceptable under the applicable law or to the regulator, the auditor is permitted, but not required, to accept the engagement. (Ref: par. .A19–.A20)

Other Factors Affecting Audit Engagement Acceptance

.08 If the preconditions for an audit are not present, the auditor should discuss the matter with management. Unless the auditor is required by law or regulation to do so, the auditor should not accept the proposed audit engagement

a. if the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or

b. if the agreement referred to in paragraph .06*b* has not been obtained.

Agreement on Audit Engagement Terms

.09 The auditor should agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. (Ref: par. .A21–.A22)

.10 The agreed-upon terms of the audit engagement should be documented in an audit engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A23–.A28)

a. The objective and scope of the audit of the financial statements

b. The responsibilities of the auditor

c. The responsibilities of management

d. A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS

e. Identification of the applicable financial reporting framework for the preparation of the financial statements

f. Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (Ref: par. .A25)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Initial Audits, Including Reaudit Engagements — Communications With the Predecessor Auditor

.11 Before accepting an engagement for an initial audit, including a reaudit engagement, when a predecessor auditor exists, the auditor should request management to authorize the predecessor auditor to respond fully to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement and (Ref: par. .A29 and .A37)

- if management authorizes the predecessor auditor to respond to the auditor's inquiries, perform the procedures required in paragraph .12.
- if management refuses to authorize the predecessor auditor to respond, or limits the response, the auditor should inquire about the reasons and consider the implications of that refusal or limitation in deciding whether to accept the engagement.

[As amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.12 If, pursuant to paragraph .11, management authorizes the predecessor auditor to respond to the auditor's inquiries, the auditor should inquire of the predecessor auditor about matters that will assist the auditor in determining whether to accept the engagement, including (Ref: par. .A30–.A33)

a. identified or suspected fraud involving

    i. management,

    ii. employees who have significant roles in internal control, or

iii. others, when the fraud resulted in a material misstatement in the financial statements.

b. matters involving noncompliance or suspected noncompliance with laws and regulations that came to the predecessor auditor's attention during the audit, other than when matters are clearly inconsequential.

[Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.13 The AICPA Code of Professional Conduct states that members have a responsibility to cooperate with each other.[2] Accordingly, if pursuant to paragraph .11, management authorizes the predecessor auditor to respond to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement, the predecessor auditor has a responsibility to respond to the auditor's inquiries on a timely basis and on the basis of known facts, absent unusual circumstances and unless prohibited by applicable law. However, if the predecessor auditor decides, due to impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to fully respond to the auditor's inquiries, the predecessor auditor should clearly state that the response is limited. Such unusual circumstances are expected to be rare. (Ref: par. .A34–.A35) [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.14 The auditor should evaluate the predecessor auditor's response, or consider the implications if the predecessor auditor provides no response or a limited response, in determining whether to accept the engagement. (Ref: par. .A36) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

.15 When the engagement is accepted, the auditor should document

a. the inquiries of the predecessor auditor and

b. the results of those inquiries.

[Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

Recurring Audits

.16 On recurring audits, the auditor should assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented. (Ref: par. .A38–.A39) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

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[2] Paragraph .02 of ET section 0.300.020. [Footnote added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

Acceptance of a Change in the Terms of the Audit Engagement

.17 The auditor should not agree to a change in the terms of the audit engagement when no reasonable justification for doing so exists. (Ref: par. .A40–.A42) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

.18 If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement for which the auditor obtains a lower level of assurance, the auditor should determine whether reasonable justification for doing so exists. (Ref: par. .A43–.A44) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

.19 If the terms of the audit engagement are changed, the auditor and management should agree on and document the new terms of the engagement in an engagement letter or other suitable form of written agreement. [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

.20 If the auditor concludes that no reasonable justification for a change of the terms of the audit engagement exists and is not permitted by management to continue the original audit engagement, the auditor should

a. withdraw from the audit engagement when possible under applicable law or regulation,

b. communicate the circumstances to those charged with governance, and

c. determine whether any obligation, either legal, contractual, or otherwise, exists to report the circumstances to other parties, such as owners, or regulators.

[Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation

.21 If law or regulation prescribes a specific layout, form, or wording of the auditor's report that significantly differs from the requirements of GAAS, the auditor should evaluate

a. whether users might misunderstand the auditor's report and, if so,

b. whether the auditor would be permitted to reword the prescribed form to be in accordance with the requirements of GAAS or attach a separate report.[3]

If the auditor determines that rewording the prescribed form or attaching a separate report would not be permitted or would not mitigate the risk of users misunderstanding the auditor's report, the auditor should not accept the audit engagement unless the auditor is required by law or regulation to do so. An audit performed in accordance with such law

[3] Paragraphs .22–.23 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

or regulation does not comply with GAAS. Accordingly, for such an audit, the auditor should not include any reference to the audit having been performed in accordance with GAAS within the auditor's report.[4] (Ref: par. .A45–.A46) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibilities regarding relevant ethical requirements in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are addressed in section 220A. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

Preconditions for an Audit

The Financial Reporting Framework (Ref: par. .06a)

.A2 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the auditor to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

.A3 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the auditor does not have suitable criteria for auditing the financial statements. In many cases, the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A6–.A8.

Determining the Acceptability of the Financial Reporting Framework

.A4 Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)

[4] Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

- Whether law or regulation prescribes the applicable financial reporting framework

.A5 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as *general purpose financial statements*.

.A6 *General purpose frameworks.* The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A7 *Special purpose frameworks.* In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses the acceptability of special purpose frameworks.[5]

.A8 After the audit engagement has been accepted, the auditor may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed, and the auditor is required by paragraph .19 to agree upon new terms of the audit engagement that reflect the change in the framework.

Agreement of the Responsibilities of Management (Ref: par. .06b)

.A9 An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph .06*b*.[6] The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.[a]

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[5] Paragraph .10 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[6] Paragraphs .05 and .A2 of section 200. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[a] In January 2013, the Professional Ethics Executive Committee adopted a provision in the "Scope and Applicability of Nonattest Services" interpretation (ET sec. 1.295.010) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. This provision provides, among other things, that financial statement preparation is considered outside the scope of the attest engagement and, therefore, constitutes a nonattest service subject to the requirements of the "Nonattest Services" subtopic (ET sec. 1.295). The provision

However, the concept of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (including information obtained from outside of the general and subsidiary ledgers) insofar as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement as required by paragraphs .09–.10. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution and those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

.A11 Section 580, *Written Representations*, requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.[7] It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other AU-C sections and, when necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

.A12 If management will not acknowledge its responsibilities or indicates that it will not provide written representations as requested, the auditor will be unable to obtain sufficient appropriate audit evidence.[8] In such circumstances, it would not be appropriate for the auditor to accept the audit engagement unless law or regulation requires the auditor to do so. In cases when the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters and the implications for the auditor's report.

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is effective for engagements covering periods beginning on or after December 15, 2014. [Footnote added, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

[7] Paragraphs .10–.11 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[8] Paragraph .A34 of section 580. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

Preparation and Fair Presentation of the Financial Statements (Ref: par. .06b(i))

.A13 In an audit of special purpose financial statements, the auditor is required by section 800 to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements.[9] This agreement is a precondition of the audit included in the terms of the engagement.

Internal Control (Ref: par. .06b(ii))

.A14 Management maintains such internal control as it determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives, due to the inherent limitations of internal control.

.A15 An independent audit conducted in accordance with GAAS does not act as a substitute for the maintenance of internal control necessary for the preparation and fair presentation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands that it has responsibility for the design, implementation, and maintenance of internal control necessary for this purpose. However, the agreement required by paragraph .06*b*(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free from deficiencies.

.A16 Management has the responsibility to determine what internal control is necessary to enable the preparation and fair presentation of the financial statements. The term *internal control* encompasses a wide range of activities within components of the system of internal control that may be described as the control environment; the entity's risk assessment process; the entity's process to monitor the system of internal control; the information system and communication; and control activities. This division, however, does not necessarily reflect how a particular entity may design, implement, and maintain its internal control or how it may classify any particular component.[10] An entity's internal control will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulations. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Additional Information (Ref: par. .06biii(2))

.A17 Additional information that the auditor may request from management for the purpose of the audit may include, when applicable, matters related to other information in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information*

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[9] Paragraph .11 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[10] Paragraph .A51 and appendix B, "Internal Control Components," of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

Included in Annual Reports. When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that an uncorrected material misstatement of the other information exists in such other information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Considerations Relevant to Smaller Entities (Ref: par. .06b)

.A18 One of the purposes of agreeing upon the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when the auditor or a third party has assisted with drafting the financial statements, it may be useful to remind management that the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion (Ref: par. .07)

.A19 Scope limitations may be imposed by management or by circumstances. Examples of scope limitations that would not preclude the auditor from accepting the engagement include the following:

- A restriction imposed by management that the auditor believes will result in a qualified opinion
- A restriction imposed by circumstances beyond the control of management

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A20 Employee benefit plans are an example of entities that are required to have an audit by law or regulation and a disclaimer of opinion is acceptable under the applicable law or to the regulator. For such entities, the auditor is neither precluded from accepting, nor required to accept, the engagement, regardless of whether management imposes a scope limitation that is expected to result in the auditor disclaiming an opinion on the financial statements as a whole. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Agreement on Audit Engagement Terms

Agreeing Upon the Terms of the Audit Engagement (Ref: par. .09)

.A21 The roles of management and those charged with governance in agreeing upon the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless in accordance with paragraph .06, the auditor is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A22 When a third party has contracted for the audit of the entity's financial statements, agreeing the terms of the audit with management of the entity is necessary in order to establish that the preconditions for an audit are present. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Engagement Letter or Other Form of Written Agreement[11] *(Ref: par. .10)*

.A23 Both management and the auditor have an interest in documenting the agreed-upon terms of the audit engagement before the commencement of the audit to help avoid misunderstandings with respect to the audit. For example, it reduces the risk that management may inappropriately rely on the auditor to protect management against certain risks or to perform certain functions that are management's responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Form and Content of the Audit Engagement Letter

.A24 The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.[12] Paragraph .06*b* of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team
- The communication of key audit matters
- The form of any other communication about the results of the audit engagement
- The expectation that management will provide written representations (see also paragraph .A11)
- The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the

[11] In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[12] Paragraphs .04–.10 of section 200. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

financial statements, including an expectation that management will provide access to information relevant to disclosures

- The agreement of management to make available to the auditor draft financial statements, including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and any accompanying other information[13] in time to allow the auditor to complete the audit in accordance with the proposed timetable
- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by management signing the engagement letter

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A25 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A26 When relevant, the following points also could be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and specialists in some aspects of the audit
- Arrangements concerning the involvement of internal auditors and other staff of the entity
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit

[13] As defined in section 720B, *Other Information in Documents Containing Audited Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Footnote renumbered by the issuance of SAS No. 147, June 2022.]

- Any restriction of the auditor's liability when not prohibited
- Any obligations of the auditor to provide audit documentation to other parties
- Additional services to be provided, such as those relating to regulatory requirements
- A reference to any further agreements between the auditor and the entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A27 Reference to the expected form and content of any reports to be issued by the auditor may include a description of the types of reports to be issued. The auditor need not describe the type of opinion expected to be expressed. An example of an audit engagement letter is set out in the exhibit "Example of an Audit Engagement Letter." [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A28 *Audits of components.* When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to obtain a separate audit engagement letter from the component include the following:

- Who engages the component auditor
- Whether a separate auditor's report is to be issued on the component
- Legal requirements regarding the appointment of the auditor
- Degree of ownership by parent
- Degree of independence of the component management from the parent entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Initial Audits, Including Reaudit Engagements — Communications With the Predecessor Auditor (Ref: par. .11–.15)

.A29 An auditor may make a proposal for an audit engagement before being granted permission to make inquiries of a predecessor auditor. The auditor may advise management in the proposal or otherwise that the auditor's acceptance of the engagement cannot be final until the inquiries have been made and the responses of the predecessor auditor have been evaluated. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A30 Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor and management, as well as the predecessor auditor's response. Such requirements provide that, except as permitted by the rules of the AICPA Code of Professional Conduct, an auditor is precluded from disclosing confidential information obtained in the course of an engagement unless management specifically consents. Relevant ethical and professional requirements also provide that both the auditor and the predecessor auditor hold in confidence information obtained from each other. This obligation applies regardless of whether the auditor accepts the engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph renumbered and amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A31 The inquiries specified in paragraph .12*a–b* are consistent with matters that the predecessor auditor communicated with those charged with governance as required by section 240, *Consideration of Fraud in a Financial Statement Audit*,[14] and section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*,[15] respectively. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

[.A32] [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph deleted by the issuance of SAS No. 147, June 2022.]

.A33 The communication with the predecessor auditor may be either written or oral. In addition to the inquiries specified in paragraph .12*a–b*, matters subject to the auditor's inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors
- The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. As amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A34 Before responding to the auditor's inquiries made pursuant to paragraph .12, the predecessor auditor may consider it appropriate to obtain legal advice to determine whether

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[14] Paragraph .40 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

[15] Paragraph .21 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. [Footnote added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

any professional or legal requirements or unusual circumstances may limit the predecessor auditor's ability to respond. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A35 When more than one auditor is considering accepting an engagement, the predecessor auditor is not expected to be available to respond to inquiries until an auditor has been selected by the entity. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph renumbered and amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

Considerations Specific to Governmental Entities

.A36 When the auditor is required by law or regulation to audit a governmental entity, inquiries of the predecessor auditor for the purpose of obtaining information about whether to accept the engagement may not be relevant. However, inquiries of the predecessor auditor may still be relevant for the purpose of obtaining information that is used by the auditor in planning and performing the audit.[16] [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A37 In accordance with generally accepted governmental auditing standards, if the law or regulation requiring an audit specifically identifies the entities to be audited, in addition to management, the auditor may find it necessary to obtain authorization from those individuals contracting for or requesting the audit and from those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

Recurring Audits (Ref: par. .16)

.A38 The following factors may make it appropriate to revise the terms of the audit engagement:

- Any indication that management misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A change of senior management
- A significant change in ownership
- A significant change in the nature or size of the entity's business

[16] Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

- A change in legal or regulatory requirements
- A change in the financial reporting framework adopted in the preparation of the financial statements
- A change in other reporting requirements

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A39 The auditor may remind management of the terms of the engagement in writing or orally. A written reminder might be a letter confirming that the terms of the preceding engagement will govern the current engagement. If the reminder is oral, audit documentation may include with whom the discussion took place, when, and the significant points discussed. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Acceptance of a Change in the Terms of the Audit Engagement

Request to Change the Terms of the Audit Engagement (Ref: par. .17)

.A40 A request from management for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding about the nature of an audit as originally requested, or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph .17, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A41 A change in circumstances that affects management's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A42 In contrast, a change may not be considered reasonable if the change appears to relate to information that is incorrect, incomplete, or otherwise unsatisfactory. An example might be when the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and management asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Request to Change to a Review or Other Service (Ref: par. .18)

.A43 Before agreeing to change an audit engagement to a review or other service, an auditor who was engaged to perform an audit in accordance with GAAS may need to assess, in addition to the matters referred to in paragraphs .A40–.A42, any legal or contractual implications of the change. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A44 If the auditor concludes that reasonable justification to change the audit engagement to a review or other service exists, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the other service would not include reference to the following:

a. The original audit engagement

b. Any procedures that may have been performed in the original audit engagement, except when the audit engagement is changed to an engagement to undertake agreed-upon procedures and, thus, reference to the procedures performed is a normal part of the report

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation (Ref: par. .21)

.A45 GAAS require that the auditor not represent compliance with GAAS unless the auditor has complied with all of the AU-C sections relevant to the audit.[17] If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, section 800 requires that the auditor's report refer to GAAS only if the auditor's report includes the minimum reporting elements.[18] In accordance with section 800, if the specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor is required to reword the prescribed form of report or attach an appropriately worded separate report.[19] When the auditor concludes that rewording the prescribed form to be in accordance with the requirements of GAAS or attaching a separate report would not be permitted, the

[17] Paragraph .22 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

[18] Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

[19] Paragraph .23 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with GAAS. The auditor is, however, encouraged to apply GAAS, including the AU-C sections that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with GAAS. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Considerations Specific to Governmental Entities

.A46 For governmental entities, specific legal or regulatory requirements may exist; for example, the auditor may be required to report directly to the legislature or the public if management attempts to limit the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Exhibit — Example of an Audit Engagement Letter (Ref: par. .A27)

.A47

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This engagement letter is intended as guidance that may be used in conjunction with the considerations outlined in this section. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed engagement letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:[1]

[*The objective and scope of the audit*]

You[2] have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

[*The responsibilities of the auditor*]

We will conduct our audit in accordance with GAAS. As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[3] However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.

[1] The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A21.

[2] Throughout this letter, references to *you*, *we*, *us*, *management*, *those charged with governance*, and *auditor* would be used or amended as appropriate in the circumstances.

[3] This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

[*The responsibilities of management and identification of the applicable financial reporting framework*]

Our audit will be conducted on the basis that [*management and, when appropriate, those charged with governance*][4] acknowledge and understand that they have responsibility

a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;

b. for 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; and

c. to provide us with

   i. access to all information of which [*management*] is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;

   ii. additional information that we may request from [*management*] for the purpose of the audit; and

   iii. unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [*management and, when appropriate, those charged with governance*], written confirmation concerning representations made to us in connection with the audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate*.]

[4] Use terminology as appropriate in the circumstances. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[Reporting]

[*Insert appropriate reference to the expected form and content of the auditor's report, including, when applicable, the reporting on other information in accordance with section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. Example follows:*]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. Circumstances may arise in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary, withdraw from the engagement.

We also will issue a written report on [*insert appropriate reference to other auditor's reports expected to be issued*] upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

[*Signed*]

[*Name and Title*]

[*Date*]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

AU-C Section 220

Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards

(Supersedes SAS No. 122.)

Source: SAS No. 146; SAS No. 149.

Effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025.

Introduction

Scope of This Section

.01 This section addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. This section also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with section 930, *Interim Financial Information*). This section is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. (Ref: par. .A1 and .A40)

.02 Although government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, and Statements on Quality Management Standards (SQMSs) are not applicable to auditors in government audit organizations,[1] this section is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.

The Firm's System of Quality Management and the Role of Engagement Teams

.03 Under SQMS No. 1, *A Firm's System of Quality Management* (QM sec. 10), the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that (Ref: par. .A2–.A3)

[1] Paragraph 5 of Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management* (QM sec. 10).

a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and

b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.[2]

.04 The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this section, for the following: (Ref: par. .A4–.A11)

a. Implementing the firm's responses to quality risks (that is, the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm

b. Given the nature and circumstances of the audit engagement, determining whether to design and implement responses at the engagement level beyond those in the firm's policies or procedures

c. Communicating to the firm information from the audit engagement that is required by the firm's policies or procedures to be communicated to support the design, implementation, and operation of the firm's system of quality management

.05 Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. (Ref: par. .A12)

.06 The public interest is served by the consistent performance of quality audit engagements that achieve the objective of this section and other AU-C sections. A quality audit engagement is achieved through planning and performing the engagement and reporting on it in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and maintaining professional skepticism.

.07 In accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,[3] the engagement team is required to plan and perform an audit with professional skepticism and to exercise professional judgment. Professional judgment is exercised in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate maintenance of professional skepticism may be demonstrated through the actions and communications of the engagement team. Such actions and communications may include specific steps to mitigate impediments that may

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[2] Paragraph 15 of SQMS No. 1.

[3] Paragraphs .17–.18 and .A22–.A31 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

impair the appropriate maintenance of professional skepticism, such as unconscious bias or resource constraints. (Ref: par. .A35–.A38)

Scalability

.08 The requirements of this section are intended to be applied in the context of the nature and circumstances of each audit. Examples follow:

- When an audit is carried out entirely by the engagement partner, which may be the case for an audit of a less complex entity, some requirements in this section are not relevant because they are conditional on the involvement of other members of the engagement team. (Ref: par. .A13–.A14)
- When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, the engagement partner may assign the design or performance of some procedures, tasks, or actions to other members of the engagement team.

The Engagement Partner's Responsibilities

.09 The engagement partner remains ultimately responsible and, therefore, accountable for compliance with the requirements of this section. Nevertheless, the engagement partner may seek assistance from others to fulfill these responsibilities. The phrase "take responsibility for..." is used for those requirements for which the engagement partner is permitted to assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team. For other requirements, this section expressly intends that the requirement or responsibility be fulfilled by the engagement partner. In such circumstances, the engagement partner may need to obtain information from the firm or other members of the engagement team. For example, when others perform supervisory and review activities, the outcomes of those activities can be taken into account by the engagement partner in fulfilling these responsibilities. (Ref: par. .A24–.A27)

Effective Date

.10 This section is effective for engagements conducted in accordance with GAAS for periods beginning on or after December 15, 2025.

Objective

.11 The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that

a. the auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements, and

b. the auditor's report issued is appropriate in the circumstances.

Definitions

.12 For purposes of GAAS, the following terms have the meanings attributed as follows:

Engagement partner.[4] The partner or other individual appointed by the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed before the engagement report is released.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the audit engagement and any other individuals who perform audit procedures on the engagement, excluding an auditor's external specialist[5] and internal auditors who provide direct assistance on an engagement.[6] (Ref: par. .A15–.A27)

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice. (Ref: par. .A28)

Inspection. Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

Network. As defined in "Definitions" (ET sec. 0.400) in the AICPA code, an association of entities that includes one or more firms. (Ref: par. .A29)

Network firm. As defined in "Definitions" in the AICPA code, a firm or other entity that belongs to a network. References to a *network firm* are to be read hereafter as "another firm or entity that belongs to the same network as the firm." (Ref: par. .A29)

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards

[4] *Engagement partner*, *partner*, and *firm* refer to their governmental equivalents when relevant.

[5] Paragraph .06 of section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

[6] Section 610, *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance.

Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA code, or by other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist of the AICPA code together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Response (in relation to a system of quality management). Policies or procedures designed and implemented by the firm to address one or more quality risks.

- Policies are statements of what should, or should not, be done to address a quality risk or risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- Procedures are actions to implement policies.

Staff. Professionals, other than partners, including any specialist the firm employs.

Requirements

Leadership Responsibilities for Managing and Achieving Quality on Audits

.13 The engagement partner should take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner should be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement. (Ref: par. .A30–.A39)

.14 In creating the environment described in paragraph .13, the engagement partner should take responsibility for clear, consistent, and effective actions being taken that reflect the firm's commitment to quality and that establish and communicate the expected behavior of engagement team members, including emphasizing the following: (Ref: par. .A32–.A36)

a. That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level

b. The importance of professional ethics, values, and attitudes to the members of the engagement team

c. The importance of open and robust communication within the engagement team and supporting the ability of engagement team members to raise concerns without fear of reprisal

d. The importance of each engagement team member maintaining professional skepticism throughout the audit engagement

.15 If the engagement partner assigns the design or performance of procedures, tasks, or actions related to a requirement of this section to other members of the engagement team to assist the engagement partner in complying with the requirements of this section, the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement through direction and supervision of those members of the engagement team and review of their work. (Ref: par. .09 and .A39)

Relevant Ethical Requirements, Including Those Related to Independence

.16 The engagement partner should have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: par. .A40–.A44 and .A50)

.17 The engagement partner should take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that address the following: (Ref: par. .A23–.A27 and .A42–.A46)

a. Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence

b. Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches

c. The responsibilities of members of the engagement team when they become aware of an instance of noncompliance with laws and regulations by the entity[7]

.18 If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner should evaluate the threats by complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources, and take appropriate action. (Ref: par. .A45–.A46)

.19 The engagement partner should remain alert throughout the audit engagement, through observation and making inquiries as necessary, for breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: par. .A47)

.20 If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled,

[7] See section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

the engagement partner, in consultation with others in the firm, should take appropriate action. (Ref: par. .A48)

.21 Prior to dating the auditor's report, the engagement partner should take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: par. .A40 and .A49)

Acceptance and Continuance of Client Relationships and Audit Engagements

.22 The engagement partner should determine that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed and that conclusions reached in this regard are appropriate. (Ref: par. .A51–.A53 and .A60)

.23 The engagement partner should take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with GAAS and complying with the requirements of this section. (Ref: par. .A55–.A58)

.24 If the engagement team becomes aware of information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner should communicate that information promptly to the firm so that the firm and the engagement partner can take the necessary action. (Ref: par. .A59)

Engagement Resources

.25 The engagement partner should determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm's policies or procedures, and any changes that may arise during the engagement. (Ref: par. .A61–.A73, .A76–.A77, and .A82)

.26 The engagement partner should determine that members of the engagement team, and any auditor's external specialists and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: par. .A64 and .A74–.A77)

.27 If, as a result of complying with the requirements in paragraphs .25–.26, the engagement partner determines that resources assigned or made available are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner should take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement. (Ref: par. .A78–.A81)

.28 The engagement partner should take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: par. .A65–.A71)

Engagement Performance

Direction, Supervision, and Review

.29 The engagement partner should take responsibility for the direction and supervision of the members of the engagement team and the review of their work. (Ref: par. .A83)

.30 The engagement partner should determine that the nature, timing, and extent of direction, supervision, and review are (Ref: par. .A84–.A92 and .A97–.A100)

a. planned[8] and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements, and

b. responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm.

.31 The engagement partner should review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to (Ref: par. .A93–.A96)

a. significant matters;[9]

b. significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and

c. other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

.32 On or before the date of the auditor's report, the engagement partner should determine, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: par. .A93–.A97)

.33 Prior to dating the auditor's report, the engagement partner should review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters[10] and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.[11]

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[8] Paragraph .11 of section 300, *Planning an Audit.*

[9] Paragraph .08 of section 230, *Audit Documentation.*

[10] See section 701, *Communicating Key Audit Matters in the Auditor's Report.*

[11] See section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 705, *Modifications to the Opinion in the Independent Auditor's Report.*

.34 The engagement partner should review, prior to their issuance, formal written communications to management, those charged with governance, or regulatory authorities. (Ref: par. .A101)

Consultation

.35 The engagement partner should do the following: (Ref: par. .A102–.A105)

a. Take responsibility for the engagement team undertaking consultation on
   i. difficult or contentious matters and matters on which the firm's policies or procedures require consultation and
   ii. other matters that, in the engagement partner's professional judgment, require consultation.
b. Determine that members of the engagement team have undertaken appropriate consultation during the audit engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm.
c. Determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted.
d. Determine that conclusions agreed have been implemented.

Engagement Quality Review

.36 For audit engagements for which an engagement quality review is required, the engagement partner should (Ref: par. .A106)

a. determine that an engagement quality reviewer has been appointed.
b. cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so.
c. discuss significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer.
d. not release the auditor's report until the completion of the engagement quality review. (Ref: par. .A107–.A109)

Differences of Opinion

.37 If differences of opinion arise within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, including those who provide consultation, the engagement team should follow the firm's policies or procedures for dealing with and resolving such differences of opinion. (Ref: par. .A110–.A111)

.38 The engagement partner should

a. take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures.

b. determine that conclusions reached are documented and implemented.

c. not date the auditor's report until any differences of opinion are resolved.

Monitoring and Remediation

.39 The engagement partner should take responsibility for the following: (Ref: par. .A112–.A115)

a. Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm, including, as applicable, the information from the monitoring and remediation process of the network and across the network firms

b. Determining the relevance and effect on the audit engagement of the information referred to in paragraph .39*a* and taking appropriate action

c. Remaining alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicating such information to those responsible for the process

Taking Overall Responsibility for Managing and Achieving Quality

.40 Prior to dating the auditor's report, the engagement partner should determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner should determine that (Ref: par. .A115–.A118)

a. the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement.

b. the nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures have been taken into account in complying with the requirements of this section.

Documentation

.41 In applying section 230, *Audit Documentation*, the auditor should include the following in the audit documentation:[12] (Ref: par. .A120–.A123)

a. Significant issues identified, relevant discussions with personnel, and conclusions reached with respect to

[12] Paragraphs .08–.11 of section 230.

i. fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence

ii. the acceptance and continuance of the client relationship and audit engagement

b. The nature and scope of, and conclusions resulting from, consultations undertaken during the audit engagement and how such conclusions were implemented

c. If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed before the release of the auditor's report

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 This section applies to all audits of financial statements, including audits of group financial statements. Statement on Auditing Standards (SAS) No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* (sec. 600), addresses special considerations that apply to an audit of group financial statements, including when component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. SAS No. 149 also provides guidance on how to adapt and apply the requirements of this section in an audit of group financial statements involving component auditors. SAS No. 149, adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, SAS No. 149 may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location. [As amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

The Firm's System of Quality Management and the Role of Engagement Teams (Ref: par. .03–.09)

.A2 SQMS No. 1 addresses a firm's responsibilities for designing, implementing, and operating its system of quality management.

.A3 Firms may use different terminology or frameworks to describe the components of the system of quality management.

The Engagement Team's Responsibilities Relating to the Firm's System of Quality Management (Ref: par. .04)

.A4 Quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with SQMS No. 1, the firm is responsible for communicating information that enables the engagement team to understand and carry out their responsibilities relating to performing engagements. For example, such communications may cover policies or procedures to undertake consultations with designated individuals in certain situations involving complex technical or ethical matters or to involve firm-designated experts in specific engagements to perform audit procedures related to particular matters (for example, the firm may specify that firm-designated credit-risk modeling experts are to be involved in auditing expected credit loss allowances in audits of financial institutions).

.A5 Firm-level responses may include policies or procedures established by a network or by other firms, structures, or organizations within the same network (network requirements or network services are described further in SQMS No. 1 within the "Network Requirements or Network Services" section).[13] The requirements of this section are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network requirements or network services on the audit engagement (for example, a requirement to use an audit methodology developed for use by a network firm). Under SQMS No. 1, the firm is responsible for determining how network requirements or network services are relevant to, and are taken into account in, the firm's system of quality management.[14]

.A6 Some firm-level responses to quality risks are not performed at the engagement level but are, nevertheless, relevant when complying with the requirements of this section. For example, firm-level responses that the engagement team may be able to depend on when complying with the requirements of this section include the following:

- Personnel recruitment and professional training processes
- The IT applications that support the firm's monitoring of independence
- The development of IT applications that support the acceptance and continuance of client relationships and audit engagements
- The development of audit methodologies and related implementation tools and guidance

.A7 Due to the specific nature and circumstances of each audit engagement and changes that may occur during the audit engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement team exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm's policies or procedures, at the engagement level to meet the objective of this section.[15]

.A8 The engagement team's determination of whether engagement-level responses are necessary (and, if so, what those responses are) is influenced by the requirements of this

[13] Paragraph 50*b* of SQMS No. 1.

[14] Paragraph 50*a* of SQMS No. 1.

[15] Section 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

section, the engagement team's understanding of the nature and circumstances of the engagement, and any changes during the audit engagement. For example, unanticipated circumstances may arise during the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

.A9 The relative balance of the engagement team's efforts to comply with the requirements of this section (that is, between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (for example, an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement team's actions in complying with the engagement performance requirements of this section may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (for example, planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

.A10 Ordinarily, the engagement team may depend on the firm's policies or procedures in complying with the requirements of this section, unless

- the engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement, or
- information provided by the firm or other parties about the effectiveness of such policies or procedures suggests they cannot be relied on (for example, information provided by the firm's monitoring activities, external inspections, or other relevant sources indicates that the firm's policies or procedures are not operating effectively).

.A11 If the engagement partner becomes aware (including by being informed by other members of the engagement team) that the firm's responses to quality risks are ineffective in the context of the specific engagement, or the engagement partner is unable to depend on the firm's policies or procedures, the engagement partner communicates such information promptly to the firm in accordance with paragraph .39*c* because such information is relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit software program has a security weakness, timely communication of such information to the appropriate personnel enables the firm to take steps to update and reissue the audit program. See also paragraph .A70 in respect of sufficient and appropriate resources.

Information Relevant to Quality Management at the Engagement Level (Ref: par. .05)

.A12 Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under section 315, *Understanding* *the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides information that may be relevant to complying with the requirements of this section. Such information may be relevant to the determination of one or more of the following:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts to deal with complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations
- The nature, timing, and extent of review of the work performed by members of the team based on the assessed risks of material misstatement
- The allocation of the budgeted audit hours, including allocating more time and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher

Scalability (Ref: par. .08)

.A13 In a smaller firm, the firm's policies or procedures may designate an engagement partner or partners, on behalf of the firm, to design many of the responses to the firm's quality risks at the engagement level because doing so may be a more effective approach to designing and implementing responses as part of the firm's system of quality management. Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence and, rather, independence will be monitored at the individual engagement level by the engagement partner.

.A14 The requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

Definitions

Engagement Team (Ref: par. .12)

.A15 The engagement team may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures[16] on the audit engagement, excluding an auditor's external specialist[17] and internal auditors who provide direct assistance on an engagement,[18] is a member of the engagement team.

[16] Paragraph .A44 of section 500, *Audit Evidence*.

[17] Paragraph .06 of section 620 defines the term *auditor's specialist*.

[18] Section 610 establishes limits on the use of direct assistance.

.A16 The definition of an *engagement team* focuses on individuals who perform audit procedures on the audit engagement. *Audit evidence*, which is necessary to support the auditor's opinion and report, is primarily obtained from audit procedures performed during the course of the audit.[19] Audit procedures comprise risk assessment procedures[20] and further audit procedures.[21] As explained in section 500, *Audit Evidence*, audit procedures may include inspection, observation, confirmation, recalculation, reperformance, analytical procedures, and inquiry, often performed in some combination.[22] Other AU-C sections may also include specific procedures to obtain audit evidence, for example, section 520, *Analytical Procedures*.

.A17 Engagement teams include personnel and may also include other individuals who perform audit procedures who are from

- a network firm, or
- a firm that is not a network firm or another service provider.[23]

For example, an individual from another firm may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count, or inspect physical fixed assets at a remote location.

.A18 Engagement teams may also include individuals from service delivery centers who perform audit procedures. For example, it may be determined that specific tasks that are repetitive or specialized in nature will be performed by a group of appropriately skilled personnel; thus, the engagement team includes such individuals. Service delivery centers may be established by the firm, the network, or by other firms, structures, or organizations within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

.A19 Engagement teams may include individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes or in analyzing complex information produced by automated tools and techniques for the purpose of identifying unusual or unexpected relationships. An individual is not a member of the engagement team if that individual's involvement with the engagement is limited to consultation. Consultations are addressed in paragraphs .35 and .A102–.A105.

.A20 If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and any other individuals performing the engagement quality review,

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[19] Paragraph .A32 of section 200.

[20] Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides requirements related to risk assessment procedures.

[21] Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides requirements related to further audit procedures, including tests of controls and substantive procedures.

[22] Paragraph .A43 of section 500.

[23] Paragraph 17 of SQMS No. 1.

are not members of the engagement team. Such individuals may be subject to specific independence requirements.

.A21 An internal auditor providing direct assistance and an auditor's external specialist whose work is used in the engagement are not members of the engagement team.[24] Section 610, *Using the Work of Internal Auditors*, and section 620, *Using the Work of an Auditor's Specialist*, provide requirements and guidance for the auditor when using the work of internal auditors in a direct assistance capacity or when using the work of an external specialist, respectively. Compliance with these AU-C sections requires the auditor to obtain sufficient appropriate audit evidence on the work performed by an internal auditor who is providing direct assistance and perform audit procedures on the work of an auditor's specialist.

.A22 When joint auditors conduct an audit, the joint engagement partners and their engagement teams collectively constitute the "engagement partner" and "engagement team" for purposes of GAAS. This section does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor. [Paragraph added, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A23 Referred-to auditors are not members of the engagement team. Referred-to auditors are not component auditors.[25] [Paragraph added, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

The Engagement Partner's Responsibilities (Ref: par. .09 and .12)

.A24 When this section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the engagement partner may need to obtain information from the firm or other members of the engagement team to fulfill the requirement (for example, information to make the required decision or judgment). For example, the engagement partner is required to determine that members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement. To make a judgment on whether the competence and capabilities of the engagement team are appropriate, the engagement partner may need to use information compiled by the engagement team or from the firm's system of quality management. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

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[24] See paragraphs .12–.13 of section 620 and paragraphs .20–.24 of section 610.

[25] Paragraph 16 of Statement on Auditing Standards (SAS) No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* (sec. 600). [Footnote added, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. .08 and .17)

.A25 Within the context of the firm's system of quality management, engagement team members from the firm are responsible for implementing the firm's policies or procedures that are applicable to the audit engagement. Engagement team members from another firm are neither partners nor staff of the engagement partner's firm. As such, they may not be subject to the firm's system of quality management or the firm's policies or procedures. Further, the policies or procedures of another firm may not be similar to those of the engagement partner's firm. For example, policies or procedures regarding direction, supervision, and review may be different, particularly when the other firm is in a jurisdiction with a different legal system, language, or culture than that of the engagement partner's firm. Accordingly, when the engagement team includes individuals who are from another firm, different actions may need to be taken by the firm or the engagement partner to implement the firm's policies or procedures with respect to the work of those individuals. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A26 In particular, the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes, and therefore, the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. SAS No. 149[26] contains guidance on obtaining an understanding of the competence and capabilities of component auditors.
- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm's training with regard to the firm's policies or procedures for relevant ethical requirements. The firm's policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual.
- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm's independence systems. The firm's policies or procedures may state that such individuals can provide evidence of their independence in relation to the audit engagement in other ways, such as through written confirmation.

[Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

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[26] Paragraphs 28 and A72–A76 of SAS No. 149. [Footnote added, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A27 When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm's policies or procedures. For example, in a group audit engagement, communicating the group auditor's policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified difficult or contentious matters that are relevant to the group financial statements to bring to the attention of the group auditor. [Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

Firm (Ref: par. .12)

.A28 The definition of *firm* in relevant ethical requirements may differ from the definition set out in this section. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

"Network" and "Network Firm" (Ref: par. .12)

.A29 The definitions of *network* or *network firm* in relevant ethical requirements may differ from those set out in this section. The AICPA code also provides guidance in relation to the terms *network* and *network firm*. Networks and other network firms may be structured in a variety of ways and are in all cases external to the firm. The provisions in this section in relation to networks also apply to any structures or organizations that do not form part of the firm but that exist within the network. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Leadership Responsibilities for Managing and Achieving Quality in Audits (Ref: par. .13–.15)

Taking Overall Responsibility for Managing and Achieving Quality

.A30 SQMS No. 1 requires the firm to establish quality objectives that address the firm's governance and leadership, which support the design, implementation, and operation of the system of quality management. The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs .13–.14 of this section, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through personal conduct and actions (such as leading by example). A culture that demonstrates a commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Scalability

.A31 The nature and extent of the actions of the engagement partner to demonstrate the firm's commitment to quality may depend on a variety of factors, including the size, structure, geographical dispersion, and complexity of the firm and the engagement team and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Sufficient and Appropriate Involvement

.A32 Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including the following:

- Taking responsibility for the nature, timing, and extent of the direction and supervision of the members of the engagement team and the review of their work in complying with the requirements of this section
- Varying the nature, timing, and extent of such direction, supervision, and review in the context of the nature and circumstances of the engagement

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Communication

.A33 Communication is the means through which the engagement team shares relevant information on a timely basis to comply with the requirements of this section, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team or with

a. the firm (for example, individuals performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management),

b. others involved in the audit (for example, internal auditors who provide direct assistance[27] or an auditor's external specialist[28]), or

c. parties that are external to the firm (for example, management, those charged with governance, or regulatory authorities).

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A34 The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the appropriate means of effective communication with the members of the engagement team. For example, to support appropriate direction, supervision, and review, the firm may use IT applications to facilitate communication between the members of the engagement team when they are performing work across different geographical locations. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

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[27] See paragraph .A47 of section 610. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[28] See paragraphs .11*c* and .A33 of section 620. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

Professional Skepticism (Ref: par. .07)

.A35 The engagement partner is responsible for emphasizing the importance of each engagement team member maintaining professional skepticism throughout the audit engagement. Conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Accordingly, when developing the overall audit strategy in accordance with section 300, *Planning an Audit*, the engagement team may need to consider whether such conditions exist in the audit engagement and, if so, what actions the firm or the engagement team may need to undertake to mitigate such impediments. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A36 Impediments to the exercise of professional skepticism at the engagement level may include the following:

- Budget constraints, which may discourage the use of sufficiently experienced or technically qualified resources, including experts, necessary for audits of entities in which technical expertise or specialized skills are needed for effective understanding, assessment of, and responses to risks and informed questioning of management.
- Tight deadlines, which may negatively affect the behavior of those who perform the work as well as those who direct, supervise, and review. For example, external time pressures may create restrictions to analyzing complex information effectively.
- Lack of cooperation or undue pressures imposed by management, which may negatively affect the engagement team's ability to resolve complex or contentious issues.
- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework, which may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
- Overreliance on automated tools and techniques, which may result in the engagement team not critically assessing audit evidence.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A37 Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including, for example, in the design and performance of audit procedures, or the evaluation of audit evidence. Examples of unconscious auditor biases that may impede the exercise of professional skepticism and, therefore, the reasonableness of the professional judgments made by the engagement team in complying with the requirements of this section may include the following:

- *Availability bias*, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- *Confirmation bias*, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief
- *Groupthink*, which is a tendency to think or make decisions as a group, discouraging creativity or individual responsibility
- *Overconfidence bias*, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions
- *Anchoring bias*, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed
- *Automation bias*, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A38 Possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level may include the following:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement
- Explicitly alerting the engagement team to instances or situations in which vulnerability to unconscious or conscious auditor biases may be greater (for example, areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise be assigned to the engagement
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with
- Involving members of the engagement team with specialized skills and knowledge or an auditor's expert to assist the engagement team with complex or subjective areas of the audit
- Modifying the nature, timing, and extent of direction, supervision, or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis, or more in-depth reviews of certain working papers for

- complex or subjective areas of the audit,
- areas that pose risks to achieving quality on the audit engagement,
- areas with a fraud risk, and
- identified or suspected noncompliance with laws or regulations

- Setting expectations for
  - less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner, and
  - more experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement and to respond positively and in a timely manner to their insights, requests for advice, or assistance
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: par. .15)

.A39 Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks, or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including the following:

- Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof, and providing any other necessary instructions and relevant information
- Directing and supervising the assignees
- Reviewing the assignees' work to evaluate the conclusions reached, in addition to the requirements in paragraphs .29–.34

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. .16–.21)

Relevant Ethical Requirements (Ref: par. .01 and .16–.21)

.A40 Section 200[29] requires that the auditor comply with relevant ethical requirements relating to financial statement audit engagements, including those requirements pertaining to independence. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, certain requirements related to independence may be applicable only when performing audits of depository institutions or employee benefit plans. Section 600A includes additional requirements and guidance to those in this section regarding communications about relevant ethical requirements with component auditors. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A41 Based on the nature and circumstances of the audit engagement, certain law, regulation, or aspects of relevant ethical requirements, such as those pertaining to noncompliance with laws or regulations, may be relevant to the engagement (for example, laws or regulations dealing with money laundering, corruption, or bribery). [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A42 The firm's information system and the resources provided by the firm may assist the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement. For example, the firm may do the following:

- Communicate the independence requirements to engagement teams.
- Provide training for engagement teams on relevant ethical requirements.
- Establish manuals and guides (that is, intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the nature and circumstances of the firm and its engagements.
- Assign personnel to manage and monitor compliance with relevant ethical requirements (for example, SQMS No. 1 requires that the firm obtains, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or provide consultation on matters related to relevant ethical requirements.
- Establish policies or procedures for engagement team members to communicate relevant and reliable information to appropriate parties within the firm or to the engagement partner, such as policies or procedures for engagement teams to
  - — communicate information about client engagements and the scope of services, including nonassurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
  - — communicate circumstances and relationships that may create a threat to independence so that the firm can evaluate whether such a threat is at an acceptable level and, if it is not, address the threat by eliminating it or reducing it to an acceptable level.

[29] Paragraphs .16 and .A15–.A21 of section 200. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

- — promptly communicate any breaches of the relevant ethical requirements, including those related to independence.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A43 The engagement partner may take into account the information, communication, and resources described in paragraph .A42 when determining whether the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A44 Open and robust communication between the members of the engagement team about relevant ethical requirements may also assist in

- drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement, and
- keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Identifying and Evaluating Threats to Compliance With Relevant Ethical Requirements (Ref: par. .17–.18)

.A45 In accordance with SQMS No. 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence for engagement team members, include policies or procedures for identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A46 Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with. For example, the "General Requirements for Performing Nonattest Services" interpretation (ET sec. 1.295.040) of the "Independence Rule" in the AICPA code provides guidance regarding safeguards for reducing threats to independence to an acceptable level when performing nonattest services for an attest client. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Breaches of Relevant Ethical Requirements (Ref: par. .19)

.A47 In accordance with SQMS No. 1, the firm is required to establish policies or procedures for identifying, communicating, evaluating, and reporting any breaches of relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Taking Appropriate Action (Ref: par. .20)

.A48 Examples of appropriate actions may include the following:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate individuals so that appropriate action can be taken, including as applicable, disciplinary action.
- Communicating with those charged with governance.
- Communicating with regulatory authorities or professional bodies. In some circumstances, communication with regulatory authorities may be required by law or regulation.
- Seeking legal advice.
- Withdrawing from the audit engagement when withdrawal is possible under applicable law or regulation.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Prior to Dating the Auditor's Report (Ref: par. .21)

.A49 Section 700, *Forming an Opinion and Reporting on Financial Statements*, requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.[30] Performing the procedures required by paragraphs .16–.21 of this section provides the basis for these statements in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Considerations Specific to Governmental Audit Organizations

.A50 Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors they employ. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. .22–.24)

.A51 SQMS No. 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A52 Information such as the following may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

[30] Paragraph .28*c* of section 700. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

- The integrity and ethical values of the principal owners, key management, and those charged with governance of the entity
- Whether sufficient and appropriate resources are available to perform the engagement
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement
- Whether the engagement team has the competence and capabilities, including sufficient time, to perform the engagement
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A53 Under SQMS No. 1, for acceptance and continuance decisions, the firm is required to make judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A54 If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained or used by the firm in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner's determination that the firm's policies or procedures have been followed and that the conclusions reached are appropriate. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A55 Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this section and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity's timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its entities or business units
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources

required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

[Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A56 Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other sections, as well as this section, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by section 210, *Terms of Engagement*[31]
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with section 315 and section 240, *Consideration of Fraud in a Financial Statement Audit*
- Understanding the group and its environments, in the case of an audit of group financial statements in accordance with SAS No. 149, and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor's specialist in accordance with section 620
- The entity's governance structure in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*, and section 265, *Communicating Internal Control Related Matters Identified in an Audit*

[Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A57 Law, regulation, or relevant ethical requirements may require the successor auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected noncompliance with laws and regulations to the proposed successor auditor. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A58 In circumstances in which the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

[31] Paragraph .09 of section 210, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

.A59 In deciding on the necessary action, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement and, if so, determine what additional steps are necessary at the engagement level (for example, the assignment of more staff or staff with specific expertise). If the engagement partner has further concerns or is not satisfied that the matter has been appropriately resolved, the firm's policies or procedures for resolving differences of opinion may be applicable. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Considerations Specific to Governmental Audit Organizations (Ref: par. .22–.24)

.A60 When the auditor is a government audit organization, the auditor may be appointed in accordance with law or regulation, and the auditor may not need to establish all policies or procedures regarding the acceptance and continuance of audit engagements. Nevertheless, the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs .22–.24 and .A51–.A59 may be valuable to such auditors in performing risk assessments and in carrying out reporting responsibilities. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Engagement Resources (Ref: par. .25–.28)

.A61 Under SQMS No. 1, the resources assigned or made available by the firm to support the performance of audit engagements include

- human resources,
- technological resources, and
- intellectual resources.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A62 Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances in which the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group auditor.[32] In such circumstances, the firm's policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available. [Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A63 A relevant consideration for the engagement partner, in complying with the requirements in paragraphs .25–.26, may be whether the resources assigned or made

[32] See paragraph A10 of SAS No. 149. [Footnote renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles such as professional competence and due care. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Human Resources

.A64 Human resources include members of the engagement team (see also paragraphs .A5 and .A15–.A21) and, when applicable, an auditor's external specialist and individuals from within the entity's internal audit function who provide direct assistance on the audit. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Technological Resources

.A65 The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technological resources may include tools that allow the auditor to more effectively and efficiently manage the audit. Technological tools may also allow the auditor to evaluate large amounts of data more easily to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Technological tools may also be used to conduct meetings and provide communication tools to the engagement team. Inappropriate use of technological resources may, however, increase the risk of overreliance on the information produced for decision-making purposes or may create threats to complying with relevant ethical requirements, for example, requirements related to confidentiality. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A66 The firm's policies or procedures may include required considerations or responsibilities for the engagement team when using firm-approved technological tools to perform audit procedures and may require, depending on the tool used, the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A67 When the engagement partner requires individuals from another firm to use specific automated tools and techniques when performing audit procedures, communications with those individuals may indicate that the use of such automated tools and techniques needs to comply with the engagement team's instructions. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A68 The firm's policies or procedures may specifically prohibit the use of certain IT applications or features of IT applications (for example, software that has not yet been specifically approved for use by the firm). Alternatively, the firm's policies or procedures may require the engagement team to take certain actions before using an IT application that is not firm approved to determine it is appropriate for use, for example, by requiring

- the engagement team to have appropriate competence and capabilities to use the technological resource.
- testing of the operation and security of the IT application.

- specific documentation to be included in the audit file.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A69 The engagement partner may exercise professional judgment in considering whether the use of an IT application on the audit engagement is appropriate in the context of the engagement, and if so, how the IT application is to be used. Factors that may be considered in determining whether a particular IT application that has not been specifically approved for use by the firm is appropriate for use in the audit engagement include whether

- use and security of the IT application comply with the firm's policies or procedures.
- the IT application operates as intended.
- personnel have the competence and capabilities required to use the IT application.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Intellectual Resources

.A70 Intellectual resources include, for example, audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A71 The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, law and regulation, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, an industry-specific methodology or related guides and performance aids. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Sufficient and Appropriate Resources to Perform the Engagement (Ref: par. .25)

.A72 In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, ordinarily, the engagement partner may depend on the firm's related policies or procedures (including resources) as described in paragraph .A6. For example, based on information communicated by the firm, the engagement partner may be able to depend on the firm's technological development, implementation, and maintenance programs when using firm-approved technology to perform audit procedures. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A73 The engagement partner may find it necessary to seek input from others with responsibilities for direction, supervision, and review to make the determinations required by paragraphs .25–.27 of this section. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Competence and Capabilities of the Engagement Team (Ref: par. .26)

.A74 When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- expertise in specialized areas of accounting or auditing.
- expertise in IT used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- knowledge of relevant industries in which the entity being audited operates.
- ability to exercise professional skepticism and professional judgment.
- understanding of the firm's policies or procedures.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A75 Internal auditors and an auditor's external specialist are not members of the engagement team. Section 610[33] and section 620[34] include requirements and guidance relating to the assessment of the competence and capabilities of internal auditors and an auditor's external specialist, respectively. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Project Management

.A76 In situations in which there are many engagement team members, for example, in an audit of a larger or more complex entity, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, in an audit of a less complex entity with few engagement team members, project management may be achieved by a member of the engagement team through less formal means. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A77 Project management techniques and tools may support the engagement team in managing the quality of the audit engagement by, for example,

- increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism.

[33] Paragraph .13 of section 610. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[34] Paragraph .09 of section 620. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

- facilitating timely performance of audit work to effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise.
- monitoring the progress of the audit against the audit plan,[35] including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources.
- facilitating communication among members of the engagement team, for example, coordinating arrangements with component auditors and auditor's experts.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

*Insufficient or Inappropriate Resources (Ref: **par. .27**)*

.A78 SQMS No. 1 addresses the firm's commitment to quality through its culture that exists throughout the firm, which recognizes and reinforces the firm's role in serving the public interest by consistently performing quality engagements, and the importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities. SQMS No. 1 also addresses the firm's responsibilities for planning for resource needs and obtaining, allocating, or assigning resources in a manner that is consistent with the firm's commitment to quality. However, in certain circumstances, the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team. In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for determining that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

[.A79] [Paragraph renumbered and deleted by the issuance of SAS No. 149, March 2023.]

.A80 The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this section and the nature and circumstances of the audit engagement. As described in paragraph .A11, in certain circumstances, the engagement partner may determine that the firm's responses to quality risks are ineffective in the context of the specific engagement, including that certain resources assigned or made available to the engagement team are insufficient. In those circumstances, the engagement partner is required to take appropriate action, including communicating such information to the appropriate individuals in accordance with paragraphs .27 and .39*c*. For example, if an audit software program provided by the firm has not incorporated new or revised audit procedures regarding recently issued industry regulation, timely communication of such information to the firm enables the firm to take steps to update and reissue the software promptly or to provide an alternative resource that enables the engagement team to comply with the new regulation in the performance of the audit engagement. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

[35] See paragraph .09 of section 300. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

.A81 If the resources assigned or made available are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, appropriate actions may include the following:

- Changing the planned approach to the nature, timing, and extent of direction, supervision, and review (see also paragraph .A97)
- Discussing an extension to reporting deadlines with management or those charged with governance, when an extension is possible under applicable law or regulation
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Considerations Specific to Audits of Governmental Entities (Ref: par. .25–.28)

.A82 For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation, such as knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or reporting in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect on the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Engagement Performance

Scalability (Ref: par. .29)

.A83 When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, it may be necessary for the engagement partner to assign direction, supervision, and review to other members of the engagement team. However, as part of the engagement partner's overall responsibility for managing and achieving quality on the audit engagement and to be sufficiently and appropriately involved, the engagement partner is required to determine that the nature, timing, and extent of direction, supervision, and review is undertaken in accordance with paragraph .30. In such circumstances, personnel or members of the engagement team, including component auditors, may provide information to the engagement partner to enable the engagement partner to make the determination required by paragraph .30. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Direction, Supervision, and Review (Ref: par. .30)

.A84 Under SQMS No. 1, the firm is required to establish a quality objective that addresses the nature, timing, and extent of the direction and supervision of engagement teams and review of their work. SQMS No. 1 also requires that such direction, supervision, and review be planned and performed on the basis that the work performed by less experienced members of the engagement team be directed, supervised, and reviewed by more experienced engagement team members. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A85 Direction and supervision of the engagement team and the review of the work of the engagement team are firm-level responses that are implemented at the engagement level, of which the nature, timing, and extent may be further tailored by the engagement partner in managing the quality of the audit engagement. Accordingly, the approach to direction, supervision, and review will vary from one engagement to the next, taking into account the nature and circumstances of the engagement. The approach will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A86 The approach to the direction and supervision of the members of the engagement team and the review of their work provides support for the engagement partner in fulfilling the requirements of this section and in concluding that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph .40. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A87 Ongoing discussion and communication among members of the engagement team allows less experienced engagement team members to raise questions with more experienced engagement team members (including the engagement partner) in a timely manner and enables effective direction, supervision, and review in accordance with paragraph .30. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Direction

.A88 Direction of the engagement team may involve informing the members of the engagement team of their responsibilities, such as the following:

- Contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions
- Maintaining a questioning mind and being aware of unconscious or conscious auditor biases in maintaining professional skepticism when gathering and evaluating audit evidence (see paragraph .A37)
- Fulfilling relevant ethical requirements
- The responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement

- The responsibilities of respective engagement team members to perform audit procedures and of more experienced engagement team members to direct, supervise, and review the work of less experienced engagement team members
- Understanding the objectives of the work to be performed and the detailed instructions regarding the nature, timing, and extent of planned audit procedures as set forth in the overall audit strategy and audit plan
- Addressing threats to the achievement of quality, and the engagement team's expected response, for example, the threat that budget constraints or resource constraints result in the engagement team members inappropriately modifying planned audit procedures or failing to perform planned audit procedures

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Supervision

.A89 Supervision may include matters such as the following:

- Tracking the progress of the audit engagement, which includes monitoring
  - — the progress against the audit plan,
  - — whether the objective of work performed has been achieved, and
  - — the ongoing adequacy of assigned resources
- Taking appropriate action to address issues arising during the engagement, including, for example, reassigning planned audit procedures to more experienced engagement team members when issues are more complex than initially anticipated
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies
- Creating an environment where engagement team members raise concerns without fear of reprisals

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Review

.A90 Review of the engagement team's work provides support for the conclusion that the requirements of this section have been addressed. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A91 Review of the engagement team's work consists of consideration of whether, for example,

- the work has been performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements;
- significant matters have been raised for further consideration;
- appropriate consultations have taken place, and the resulting conclusions have been documented and implemented;
- there is a need to revise the nature, timing, and extent of work performed;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion; and
- the objectives of the audit procedures have been achieved.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A92 The firm's policies or procedures may contain specific requirements regarding

- the nature, timing, and extent of review of audit documentation;
- different types of review that may be appropriate in different situations (for example, review of each individual working paper or selected working papers); and
- which members of the engagement team are required to perform the different types of review.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

The Engagement Partner's Review (Ref: par. .30–.34)

.A93 As required by section 300, the engagement partner reviews the overall audit strategy and audit plan.[36] As required by section 230, the engagement partner documents the date and extent of the review.[37] [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A94 Timely review of documentation by the engagement partner at appropriate stages throughout the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation. The engagement partner exercises professional judgment in determining the extent of documentation to be reviewed, for example, when determining the nature and extent of the review of component auditor documentation in a group audit. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

[36] Paragraph .11 of section 300, as amended by Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (sec. 220). [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[37] Paragraph .09*c* of section 230. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

.A95 The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
  - — The composition of the engagement team, including
    - personnel using expertise in a specialized area of accounting or auditing
    - the use of personnel from service delivery centers
  - — The decision to involve an auditor's specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom
- In group audit situations,
  - — the proposed overall group audit strategy and group audit plan;
  - — decisions about the involvement of component auditors, including how to direct and supervise them and review their work; and
  - — the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement

- The proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.

[Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

.A96 The engagement partner exercises professional judgment in determining other matters to review, for example, based on

- the nature and circumstances of the audit engagement.
- which engagement team member performed the work.
- matters relating to recent inspection findings.
- the requirements of the firm's policies or procedures.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Nature, Timing, and Extent

.A97 The nature, timing, and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures, as well as professional standards and applicable legal and regulatory requirements. For example, the firm's policies or procedures may include the following:

- Work planned to be performed at an interim date is to be directed, supervised, and reviewed at the same time as the performance of the procedures, rather than at the end of the period, so that any necessary corrective action can be taken in a timely manner.
- Certain matters are to be reviewed by the engagement partner, and the firm may specify the circumstances or engagements in which such matters are expected to be reviewed.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Scalability

.A98 The following are examples of factors that may influence the firm's approach to direction, supervision, and review:

- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less, and the review of the related working papers may be less detailed.

- The complexity of the audit engagement. For example, if significant events have occurred that make the audit engagement more complex, the extent and frequency of the direction and supervision of the engagement team member may be greater, and the review of the related working papers may be more detailed.
- The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.
- The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced engagement team members may require more detailed instructions and more frequent, or in-person, interactions as the work is performed.
- The manner in which the reviews of the work performed are expected to take place. For example, in some circumstances, remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
- The structure of the engagement team and the location of engagement team members. For example, direction and supervision of individuals located at service delivery centers and the review of their work may
  - — be more formalized and structured than when members of the engagement team are all situated in the same location or
  - — use IT to facilitate the communication between the members of the engagement team.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A99 Identification of changes in the engagement circumstances may warrant reevaluation of the planned approach to the nature, timing, or extent of direction, supervision, or review. For example, if the assessed risk of material misstatement at the financial statement level increases because of a complex transaction, the engagement partner may need to change the planned level of review of the work related to the transaction. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A100 In accordance with paragraph .30*b*, the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced engagement team member becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Review of Communications to Management, Those Charged With Governance, or Regulatory Authorities (Ref: par. .34)

.A101 The engagement partner uses professional judgment in determining which written communications to review, taking into account the nature and circumstances of the audit engagement. For example:

- It may not be necessary for the engagement partner to review communications between the engagement team and management in the ordinary course of the audit.
- In group audit situations, the engagement partner may determine to review formal written communications to group management, those charged with governance of the group, or regulatory authorities relevant to the group.

[Paragraph renumbered and amended, effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, by SAS No. 149.]

Consultation (Ref: par. .35)

.A102 SQMS No. 1 requires the firm to establish a quality objective that addresses consultation on difficult or contentious matters and how the conclusions agreed are implemented. Consultation may be appropriate or required, for example, for

- issues that are complex or unfamiliar (for example, issues related to an accounting estimate with a high degree of estimation uncertainty),
- significant risks,
- significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual,
- limitations imposed by management, and
- noncompliance with laws or regulations.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A103 Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm, may be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, seniority, and experience.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A104 It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, in areas where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A105 The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.[38] [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Engagement Quality Review (Ref: par. .36)

.A106 SQMS No. 1 contains requirements that the firm establish policies or procedures addressing engagement quality reviews in accordance with SQMS No. 2, *Engagement Quality Reviews* (QM sec. 20),[39] and requiring an engagement quality review for certain types of engagements.[40] SQMS No. 2 deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Completion of the Engagement Quality Review Before Dating of the Auditor's Report (Ref: par. .36d)

.A107 Section 700 requires the auditor's report to 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.[41] If applicable to the audit engagement, SQMS No. 2 and this section require that the engagement partner be precluded from releasing the engagement report until notification has been received from the engagement quality reviewer that the engagement quality review is complete. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate, then the engagement quality review is not complete.[42] [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A108 An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A109 Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for

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[38] Paragraphs .09 and .A13*b* of section 701. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[39] SQMS No. 2, *Engagement Quality Reviews* (QM sec. 20). [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[40] Paragraph 35*f* of SQMS No. 1. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[41] Paragraph .43 of section 700. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

[42] Paragraph 21*b* of SQMS No. 2. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

coordinating requests from the engagement quality reviewer to another member of the engagement team. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Differences of Opinion (Ref: par. .37–.38)

.A110 SQMS No. 1 requires the firm to establish a quality objective that addresses differences of opinion that arise within the engagement team or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management. SQMS No. 1 also requires that differences of opinion be brought to the attention of the firm and resolved. For example, a component auditor may be instructed to communicate differences of opinion to the group engagement team. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A111 In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example,

- seeking legal advice or
- withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Monitoring and Remediation (Ref: par. .39)

.A112 SQMS No. 1 sets out requirements for the firm's monitoring and remediation process. SQMS No. 1 requires the firm to communicate to engagement teams information about the firm's monitoring and remediation process to enable them to take prompt and appropriate action in accordance with their responsibilities. Further, information provided by members of the engagement team may be used by the firm in the firm's monitoring and remediation process, and exercising professional judgment and maintaining professional skepticism while conducting the audit may assist the members of the engagement team in remaining alert for information that may be relevant to that process. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A113 Information provided by the firm may be relevant to the audit engagement when, for example, it relates to findings on another engagement performed by the engagement partner or other members of the engagement team, findings from the local firm office, or inspection results of previous audits of the entity. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A114 In considering information communicated by the firm through its monitoring and remediation process and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to address deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that

- an auditor's specialist is needed or
- the nature, timing, and extent of direction, supervision, and review need to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (for example, if it relates to a technological resource that the engagement team did not use), then no further action may be needed. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A115 A deficiency in the firm's system of quality management does not necessarily indicate that an audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate in the circumstances. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Taking Overall Responsibility for Managing and Achieving Quality (Ref: par. .40)

.A116 SQMS No. 1 requires the firm to establish a quality objective addressing the engagement team's understanding and fulfillment of their responsibilities in connection with the engagement. SQMS No. 1 further requires that the quality objective include the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A117 Relevant considerations in addressing paragraph .40 include determining how the engagement partner has complied with the requirements of this section, given the nature and circumstances of the audit engagement and how the audit documentation evidences the engagement partner's involvement throughout the audit engagement, as described in paragraph .A119. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A118 Indicators that the engagement partner may not have been sufficiently and appropriately involved include, for example, the following:

- Lack of timely review by the engagement partner of the audit engagement planning, including reviewing the assessment of risks of material misstatement and the design of responses to those risks toward the end of the audit
- Evidence that assignees were not provided necessary instructions and relevant information, such as not being adequately informed about the nature of their responsibilities and authority, the scope of the work being assigned, and the objectives thereof
- A lack of evidence of the engagement partner's direction and supervision of the other members of the engagement team and the review of their work

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A119 If the engagement partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph .40. In addition to taking into account firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example,

- updating and changing the audit plan,
- reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner, or
- consulting with personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Documentation (Ref: par. .41)

.A120 In accordance with section 230,[43] audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (such as in a checklist) compliance with matters for which compliance is demonstrated by documents included within the audit file. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A121 Documentation of the performance of the requirements of this section, including evidencing the involvement of the engagement partner and the engagement partner's determination in accordance with paragraph .40, may be accomplished in different ways depending on the nature and circumstances of the audit engagement. Examples follow:

- Direction of the engagement team can be documented through sign-offs of the audit plan and project management activities.
- Minutes from formal meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions regarding culture and expected behaviors that demonstrate the firm's commitment to quality.
- Agendas from discussions between the engagement partner and other members of the engagement team and, when applicable, the engagement quality reviewer, and related sign-offs and records of the time the engagement partner spent on the engagement, may provide evidence of the engagement partner's involvement throughout the audit engagement and supervision of other members of the engagement team.
- Sign-offs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

[43] Paragraph .A9 of section 230. [Footnote renumbered by the issuance of SAS No. 149, March 2023.]

.A122 When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph .24), the documentation may include explanations of how the engagement team dealt with the circumstance. [Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

.A123 Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the nature and scope of the issue on which consultation was sought and
- the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented.

[Paragraph renumbered by the issuance of SAS No. 149, March 2023.]

Appendix — Amendments to Various Statements on Auditing Standards, as Amended, and Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, Section 105, *Concepts Common to All Attestation Engagements*, in AICPA *Professional Standards*

.A124

Amendment to Statement on Auditing Standards (SAS) No. 117, *Compliance Audits*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 935, *Compliance Audits*

[No amendment to paragraphs .01–.A34.]

.A35 ~~Section 220,~~***Statement on Auditing Standards (SAS) No. 146,*** *Quality* ~~*Control*~~ **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner ***determine***, through a review of the audit documentation and discussion with the engagement team, ~~be satisfied~~ that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[fn 20] When an engagement quality ~~control~~ review is performed, ~~section 220~~ ***SAS No. 146*** requires that the auditor's report not be released ~~prior to~~ ***until*** the completion of the engagement quality ~~control~~ review.[fn 21]

fn 20 ~~See paragraph~~ ***Paragraph*** ~~19~~ ***32*** of ~~section 220,~~ ***SAS No. 146,*** *Quality* ~~*Control*~~ **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~, for further discussion~~.

fn 21 Paragraph ~~21~~***36d*** of ~~section 220~~ ***SAS No. 146***.

[No further amendment to section 935.]

1. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2025.

Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

[No amendment to paragraphs .01–.A19.]

.A20 ~~QC section 10~~***Statement on Quality Management Standards (SQMS) No. 1,*** *A Firm's System of Quality ~~Control~~* **Management**, sets out the firm's responsibilities to ~~establish and maintain its~~ ***design, implement, and operate a*** system of quality ~~control for audit engagements, and to establish policies and procedures designed to provide it~~ ***management that provides the firm*** with reasonable assurance that the firm and its personnel ***fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements. SQMS No. 1 requires the firm, as part of its system of quality management, to establish quality objectives that address the fulfillment of responsibilities in accordance***~~comply~~ with relevant ethical requirements, including those ~~pertaining~~ ***related*** to independence.[fn 7] ~~Section 220~~ ***Statement on Auditing Standards (SAS) No. 146***, *Quality ~~Control~~* **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards****,*** addresses the engagement partner's responsibilities regarding relevant ethical requirements***, including those related to independence***.~~These include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team, determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.~~[fn 8] ~~Section 220~~ ***SAS No. 146*** ~~recognizes that~~ ***also describes when*** the engagement team ~~is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties~~ ***may depend on the firm's policies or procedures in managing and achieving quality at the engagement level.***[fn 9]

fn 7 Paragraphs ~~.21–.25~~ ***30*** of ~~QC section 10~~ ***Statement on Quality Management Standards (SQMS) No. 1,*** *A Firm's System of Quality ~~Control~~***Management**.

fn 8 Paragraphs ~~11~~***16***~~–.13~~***21*** of ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146***, *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

fn 9 Paragraph A10 of SAS No. 146.

[No amendment to paragraphs .A21–.A31. Subsequent footnotes are renumbered.]

.A32 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[13]) or ***through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement*** ~~firm's quality control procedures for client acceptance or continuance~~. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by a specialist employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

fn 13 [Footnote omitted for purposes of this standard.]

[No further amendment to section 200.]

2. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 210, Terms of Engagement

[No amendment to paragraphs .01–.18.]

.A1 ***Statement on Quality Management Standards No. 1,* A Firm's System of Quality Management*, addresses the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements.*** The auditor's responsibilities regarding relevant ethical requirements***, including those related to independence,*** in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are dealt with in ~~section 220~~ ***Statement on Auditing Standards No. 146*, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

[No further amendment to section 210.]

3. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 230, Audit Documentation

[No amendment to paragraphs .01–.02.]

.03 Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance

with ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146***, *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*[fn 3]

- Enabling the engagement team to demonstrate that it is accountable for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retaining a record of matters of continuing significance to future audits of the same entity
- Enabling the conduct of ***engagement*** quality ~~control~~ reviews***, other types of engagement reviews, and monitoring activities under the firm's system of quality management*** ~~inspections in accordance with QC section 10,~~ ~~*A Firm's System of Quality Control*~~
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory**,** or other requirements
- Assisting an auditor who reviews a predecessor auditor's audit documentation
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement

[fn 3] Paragraphs ~~.17–.19~~ ***29–33*** of ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146***, *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[No amendment to paragraphs .04–.A8.]

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.
- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

— For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with GAAS. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.

— Similarly, that the engagement partner has taken responsibility for the direction~~,~~ ***and*** supervision~~, and performance of~~ the ***engagement team and review of their work*** ***fn 6***~~audit in compliance with GAAS~~ may be evidenced in a number of ways within the audit documentation. This may include documentation ~~of~~***that evidences*** the engagement partner's ~~timely~~***sufficient and appropriate*** involvement in ~~aspects of~~ the audit, such as participation in ~~the~~***engagement*** team discussions. ~~required by section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. fn 6~~

fn 6 ***Paragraph 29 of SAS No. 146.***

[No amendment to paragraphs .A10–.A14.]

.A15 ~~Section 220~~***SAS No. 146 contains requirements and guidance on the*** ~~requires the auditor to review the audit work performed through~~ review of ~~the~~ audit documentation.[fn 9] The requirement to document who reviewed the audit work performed and the extent of the review, in accordance with the firm's policies and procedures addressing review responsibilities does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

fn 9 Paragraph ~~09~~***31*** of ~~section 220~~ ***SAS No. 146.***

[No amendment to paragraphs .A16–.A22.]

Matters Arising After the Date of the Auditor's Report (Ref: par. .14)

.A23 Examples of rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report include

- when, after the date of the auditor's report, the auditor becomes aware of facts that existed at that date and which, if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor's report.[fn 11]

- when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial information.[fn 12]

The resulting changes to the audit documentation are reviewed in accordance with the firm's ~~quality control~~ procedures ~~as required by QC section 10~~ ***under its system of quality management***.

fns 11–12 [Footnotes omitted for purposes of this standard.]

Assembly and Retention of the Final Audit File (Ref: par. .16–.18)

.A24 Statutes, regulations, or the audit firm's ~~quality control~~ policies ***or procedures under its system of quality management*** may specify a period of time shorter than 60 days following the report release date in which this assembly process is to be completed.

[No amendment to paragraphs .A25–.A26.]

.A27 ~~Firms are required to establish policies and procedures for the retention of engagement documentation.~~[fn 13] Statutes, regulations, or the audit firm's ~~quality control~~ policies ***or procedures under its system of quality management*** may specify a retention period longer than five years.

~~fn 13 Paragraph .50 of QC section 10.~~

.A28 An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to clarify existing audit documentation arising from comments received during monitoring ~~inspections performed by internal~~ ***activities*** or external ~~parties~~ ***inspections***.

[No further amendment to section 230.]

4. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 260, The Auditor's Communication With Those Charged With Governance

[No amendment to paragraphs .01–.A36.]

.A37 To the extent not already addressed by the requirements in paragraph .12*a*–.*f* and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality ~~control~~ reviewer, if one has been appointed~~, in accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~.[fn 14]

~~fn 14 Paragraphs .21–.22 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.~~

[No amendment to paragraphs .A38–.A50.]

.A51 Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The following are examples of the timing of communications for certain matters:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- It may be appropriate to communicate significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- When section 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.

The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor's report:

- Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor's report, including possible implications with respect to future financial statements.
- Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired.
- Significant findings or issues from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.
- An expectation by the auditor that the opinion in the auditor's report will be modified in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.[fn 16]
- When section 701 applies, the matters planned to be included in the auditor's report***. SAS No. 146,* Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires the engagement partner, prior to dating the auditor's report, to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.*[17]**

fn 16 Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

***fn 17 Paragraph 33 of SAS No. 146*, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

[Subsequent footnotes are renumbered.]

[No further amendment to section 260.]

5. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 300, Planning an Audit

Introduction

Scope of This Section

[No amendment to paragraph .01.]

~~The Role and Timing of Planning~~

.02 Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. ~~Adequate~~***Quality management at the engagement level in accordance with Statement on Auditing Standards (SAS) No. 146,* Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, in conjunction with adequate*** planning ***in accordance with this section,*** benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit
- Helping the auditor identify and resolve potential problems on a timely basis
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

[No amendment to paragraphs .03–.05.]

Preliminary Engagement Activities

.06 The auditor should undertake the following activities at the beginning of the current audit engagement:

a. Performing procedures required by ~~section 220,~~ ***SAS No. 146*** regarding the ***acceptance and*** continuance of the client relationship and the ~~specific~~ audit engagement~~;~~

b. Evaluating compliance with relevant ethical requirements in accordance with ~~section 220,~~ ***SAS No. 146***

c. Establishing an understanding of the terms of the engagement, as required by section 210, *Terms of Engagement*~~.~~ (Ref: par. .A6–.A8)

[No amendment to paragraph .07.]

Planning Activities

.08 In establishing the overall audit strategy, the auditor should ***consider the information obtained from complying with the requirements of SAS No. 146 and***

a. identify the characteristics of the engagement that define its scope;

b. ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

c. consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;

d. consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and

e. ascertain the nature, timing, and extent of resources necessary to perform the engagement. (Ref: par. .A9–.A13)

.09 The auditor should develop an audit plan that includes a description of the following:

a. The nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work (Ref: par. ~~.A18–A19~~.A14–.A15)

b. ~~*a.*~~ The nature and extent of planned risk assessment procedures, as determined under section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

c. ~~*b.*~~ The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

d. ~~*c.*~~ Other planned audit procedures that are required to be carried out so that the engagement complies with generally accepted auditing standards (Ref: par. ~~.A14–~~.A16***–.A18***)

[No amendment to paragraph .10.]

.11 The ~~auditor~~***engagement partner*** should ~~plan the nature, timing, and extent of direction and supervision of engagement team members and the review of their work~~ ***review the overall audit strategy and audit plan***. ~~(Ref: par. .A18–.A19)~~

[No amendment to paragraphs .12–.13.]

Documentation

.14 The auditor should include in the audit documentation the following:[fn 3]

a. The overall audit strategy

b. The audit plan

c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan***, including any significant changes to the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work,***[fn 4] and the reasons for such changes. (Ref: par. .A23–.A26)

fn 3 [Footnote omitted for purposes of this standard.]

***fn 4 Paragraphs 30 and A93–A94 of SAS No. 146*, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

Application and Other Explanatory Material

.A1 SAS No. 146 addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. Information obtained from complying with the requirements of SAS No. 146 is relevant to this section. For example, in accordance with SAS No. 146, the engagement partner is required to determine that sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, taking into account the nature and circumstances of the audit engagement. Such a determination is directly relevant when ascertaining the nature, timing, and extent of resources necessary to perform the engagement in the overall strategy, as required by paragraph .08 of this section.

The Role and Timing of Planning (Ref: par. .01)

~~**.A1**~~ ***.A2*** The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement. ***In planning the audit, the auditor may use project management techniques and tools. SAS No. 146***[fn 5] ***describes how such techniques and tools may support the engagement team in managing the quality of the engagement.***

fn 5 Paragraphs A73–A74 of SAS No. 146.

[Subsequent footnotes are renumbered.]

[No amendment to paragraph .A2, renumbered as paragraph .A3.]

~~.A3~~ ***.A4*** The auditor may decide to discuss elements of planning with the entity's management to ~~facilitate the conduct and management of the audit~~ ***help the auditor manage and achieve quality at the*** engagement ***level*** (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

[No amendment to paragraphs .A4–.A5, renumbered as paragraphs .A5–.A6.]

Preliminary Engagement Activities (Ref: par. .06)

.A~~6~~7 Performing the preliminary engagement activities, which are specified in paragraph .06, at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to ~~plan and perform the audit engagement~~ ***manage and achieve quality at the engagement level in accordance with SAS No. 146.***

~~.A7~~ ***A8*** Performing these preliminary engagement activities enables the auditor to plan an audit engagement ~~for which~~ ***to***, for example,

- ~~the auditor maintains~~ ***maintain*** the necessary independence and ability to perform the engagement.
- ***determine that*** the auditor has no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- ***determine that there is*** ~~the auditor has~~ no misunderstanding ***between the auditor and*** ~~with~~ the entity about the terms of the engagement.

.~~A8~~*A9* ~~The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur.~~ Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: par. .07–.08)

.~~A9~~*A10* The process of establishing the overall audit strategy ~~assists the auditor to determine~~, subject to the completion of the auditor's risk assessment procedures, ***may include*** such matters as the following:

- The ***nature of*** resources ***(human, technological, or intellectual)*** to ~~deploy~~***be deployed*** for specific audit areas, ~~such as~~ ***for example,*** the ~~use~~***deployment*** of ~~appropriately~~ experienced team members for high-risk areas or the ~~involvement~~***assignment*** of specialists ~~on~~ ***to address*** complex matters
- The amount of resources to ~~allocate~~ ***be allocated*** to specific audit areas, ~~such as~~***for example,*** the number of team members assigned to ~~observe~~***attend*** the ***physical*** inventory count at ~~material~~***multiple*** locations, the extent of review of component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high-risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are ~~managed,~~ directed, ~~and~~ supervised, ~~such as~~ ***or used, for example,*** when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on-site or off-site)~~, and whether to complete engagement quality control reviews~~

[No amendment to paragraphs .A10–.A17, renumbered as paragraphs .A12–.A19.]

.A11 SAS No. 146 contains requirements and guidance on engagement resources and engagement performance (including direction and supervision of the members of the engagement team and the review of their work).

Direction, Supervision, and Review (Ref: par. .11)

.~~A18~~*A20* ***SAS No. 146 addresses the engagement partner's responsibility for the*** ~~The~~ nature, timing, and extent of ~~the~~ direction and supervision of engagement team members and review of their work. ***fn 10*** ~~vary, depending on many factors, including the following:~~

- ~~The size and complexity of the entity~~
- ~~The area of the audit~~
- ~~The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members and a more detailed review of their work)~~
- ~~The capabilities and competence of the individual team members performing the audit work~~

~~Section 220 contains further guidance on the direction, supervision, and review of audit work.~~

fn 10 ***Paragraphs 29–31 of SAS No. 146.***

[Subsequent footnotes are renumbered.]

~~*Considerations Specific to Smaller, Less Complex Entities*~~ **Scalability**

.~~A19~~*A21* If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved, and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor's professional body.

[No amendment to paragraphs .A20–.A21, renumbered as paragraphs .A22–.A23.]

Additional Considerations in Initial Audit Engagements (Ref: par. .13)

.~~A22~~*A24* The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Arrangements to be made with the predecessor auditor (for example, to review the predecessor auditor's working papers [see section 510, *Opening Balances —Initial Audit Engagements, Including Reaudit Engagements*])[fn 8]
- Any major issues (including the application of accounting principles or auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance, and how these matters affect the overall audit strategy and audit plan
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (see section 510)[fn 9]
- Other ~~procedures required~~ ***responses designed and implemented*** by the ~~firm's system of quality control~~ ***firm*** for initial audit engagements (For example, the firm's system of quality ~~control~~***management*** may ***include responses that*** require ~~the involvement of~~ another partner or ~~senior~~ individual ***with appropriate authority*** to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance.)

fns 8–9 [Footnotes renumbered as 11 and 12, and omitted for purposes of this standard.]

Documentation (Ref: par. .14)

~~.A23~~ *.A25* The documentation of the overall audit strategy is a record of the key decisions ~~considered necessary to properly plan the audit~~ ***in managing quality at the***

engagement level and ***a means to*** communicate significant issues to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing, and conduct of the audit.

.A26 Documentation of the direction and supervision of engagement team members and the review of their work in accordance with SAS No. 146 may also provide a record of significant changes to the planned nature, timing, and extent of the direction, supervision, and review.

[No amendment to paragraphs .A24–.A26, renumbered as paragraphs .A27–.A29.]

Appendix — Considerations in ~~Establishing the Overall Audit Strategy~~ *Managing Quality at the Engagement Level* **(Ref: par. .07–.08 and .A9–.A12)**

.~~A27~~*A30*

This appendix provides examples of matters the auditor may consider in ~~establishing the overall audit strategy~~***managing quality at the engagement level***. Many of these matters ~~also~~ will influence the auditor's ***overall audit strategy and*** detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

...

Nature, Timing, and Extent of Resources

The following examples illustrate the nature, timing, and extent of resources:

- The ~~selection~~***human, technological, and intellectual resources assigned or made available to the engagement (for example, assignment*** of the engagement team ~~(including, when necessary, the engagement quality control reviewer [see section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*])~~ and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas in which there may be higher risks of material misstatement
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas in which there may be higher risks of material misstatement

[No further amendment to section 300.]

6. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)

Introduction

Scope of This Section

[No amendment to paragraphs .01–.04.]

.05 In accordance with ~~section 220,~~ ***Statement on Auditing Standards (SAS) No. 146,*** *Quality* ~~*Control*~~**Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, the group engagement partner is required to ~~be satisfied~~ ***determine*** that those performing the group audit engagement~~, including component auditors,~~ collectively possess the appropriate competence and capabilities**,** ***including sufficient time***.[fn 1] ***Those performing the group audit engagement include component auditors whose work the group auditor assumes responsibility for but not component auditors whose audits the group auditor makes reference to (see paragraph .08).*** The group engagement partner also is responsible for the direction ***and***~~,~~ supervision ***of members of the group engagement team*** and ~~performance of the group audit engagement~~ ***review of their work.fn 2*** In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

fn 1 Paragraph***s*** ~~16~~ ***25–26*** of ~~section 220,~~ ***Statement on Auditing Standards (SAS) No. 146,*** *Quality* ~~*Control*~~ **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

fn 2 Paragraphs 29–31 of SAS No. 146.

[Subsequent footnotes are renumbered.]

[No further amendment to section 600.]

7. This amendment is effective for audits of group financial statements for periods beginning on or after December 15, 2025.

AU-C Section 620, Using the Work of an Auditor's Specialist

[No amendment to paragraphs .01–.07.]

.08 The nature, timing, and extent of the auditor's procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

a. the nature of the matter to which the work of the auditor's specialist relates;

b. the risks of material misstatement in the matter to which the work of the auditor's specialist relates;

c. the significance of the work of the auditor's specialist in the context of the audit;

d. the auditor's knowledge of, and experience with, previous work performed by the auditor's specialist; and

e. whether the auditor's specialist is subject to the auditor's firm's ***system of*** quality ***management*** ~~control policies and procedures~~. (Ref: par. .A12–.A14)

[No amendment to paragraphs .09–.A6.]

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146,*** **Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,** to ~~be satisfied~~ ***determine*** that the engagement team and any external auditor's specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities***, including sufficient time,*** to perform the audit engagement.[fn 6] Further, the auditor is required by section 300 to ascertain the nature, timing, and extent of resources necessary to perform the engagement.[fn 7] The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

[fn 6] Paragraph ~~16~~***26*** of ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146,*** **Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

[fn 7] [Footnote omitted for purposes of this standard.]

[No amendment to paragraphs .A8–.A10.]

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.
- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.
- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's ***system of*** quality ***management***~~control policies and procedures~~.

The Auditor's Firm's System of ***Quality*** ~~***Control Policies and Procedures***~~ Management ***(Ref: par. .08e)***

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff ***(that is, personnel)***, of the auditor's firm and, therefore, subject to the ***system of*** quality ~~control policies and procedures~~***management*** of that firm in accordance with ~~QC section 10,~~ ***Statement on Quality Management Standards (SQMS) No. 1,*** *A Firm's System of Quality* ~~*Control*~~**Management**.[fn 10] An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, ***and is subject to the firm's policies or procedures for network requirements and network services in accordance with SQMS No. 1. In some instances, the auditor's internal specialist of a network firm may be subject to*** ~~which may share~~ common quality ~~control~~***management*** policies ~~and~~***or*** procedures ~~with~~***as*** the auditor's firm***, given that they are part of the same network***.

fn 10 Paragraph ~~13~~***17*** of ***Statement on Quality Management Standards (SQMS) No. 1***, *A Firm's System of Quality Management*.

.A13 ~~In accordance with~~ ***As described in*** ~~section 220~~ ***SAS No. 146***, ***quality management at the*** engagement ~~teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.~~ ~~[fn 11]~~ ~~The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's~~ ***level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement.[fn 12] For example, the auditor may be able to depend on the firm's related policies or*** procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.
- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those ~~pertaining~~***relating*** to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training ~~and other firm processes, such as protocols for scoping the work of the auditor's internal specialists,~~ may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

~~Such reliance~~ ***Matters that the auditor may take into account when determining whether to depend on the firm's policies or procedures are described in SAS No. 146.[fn 13] Depending on the firm's policies or procedures*** does not reduce the auditor's responsibility to meet the requirements of this section.

~~fn 11 Paragraph .05 of section 220.~~

fn 12 Paragraph A4 of SAS No. 146.

fn 13 ***Paragraphs 4*b *and A10 of SAS No. 146.***

.A14 ***SQMS No. 1 requires the firm to address the use of resources from a service provider, which includes the use of an external specialist.***[*fn 14*] An auditor's external specialist is not a member of the engagement team and is not subject to ~~quality control policies and procedures in accordance with QC section 10~~ ***the firm's policies or procedures under its system of quality management.***[*fn 15*] ***Furthermore, the firm's policies or procedures for relevant ethical requirements may include policies or procedures that apply to the auditor's external specialist***.[fn 12*16*]

fn 14 ***Paragraph 33 of SQMS No. 1.***

fn 15 ***Paragraph 17 of SQMS No. 1.***

fn 12*16* Paragraph ~~13~~***30*b** of ~~QC section 10~~ ***SQMS No. 1.***

[Subsequent footnotes are renumbered.]

[No proposed amendment to paragraph .A15.]

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The ***system of*** quality ***management*** ~~control policies and procedures~~ of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

[No amendment to paragraphs .A17–.A28.]

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example,

- planning memoranda or related working papers, such as the audit program.
- the policies ~~and~~***or*** procedures of the auditor's firm***'s system of quality management***. In the case of an auditor's internal specialist, the ~~established policies and procedures to which the auditor's specialist is subject~~***firm's system of quality management*** may include ~~particular~~ policies ~~and~~***or*** procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies ~~and~~ ***or*** procedures. For example, no documentation may be

required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

[No further amendment to section 620.]

8. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 930, Interim Financial Information

[No amendment to paragraphs .01–.A59.]

.A60 When an engagement quality ~~control~~ review is performed, ~~section 220,~~ ***Statement on Auditing Standards (SAS) No. 146,*** *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that the ***engagement partner not date the*** auditor's report ~~not be released prior to~~ ***until*** the completion of the engagement quality ~~control~~ review.[fn 27]

[fn 27] Paragraph ~~21~~***36*****d** of ~~section 220~~ ***Statement on Auditing Standards (SAS) No. 146,*** *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[No further amendment to section 930.]

9. This amendment is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2025.

Amendment to SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

[No amendment to paragraphs .01–.A116.]

.A117 ~~Section 220,~~***Statement on Auditing Standards (SAS) No. 146,*** *Quality ~~Control~~* **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner ***determine***, through a review of the audit documentation and discussion with the engagement team, ~~be satisfied~~ that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[fn 25] When an engagement quality ~~control~~ review is performed, ~~section 220~~ ***SAS No. 146*** requires that the ***engagement partner not date the*** auditor's report ~~not be released prior to~~ ***until*** the completion of the engagement quality ~~control~~ review.[fn 26]

fn 25 ~~See paragraph~~***Paragraph*** ~~19~~***32*** of ~~section 220,~~***SAS No. 146,*** *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~, for further discussion~~.

fn 26 Paragraph ~~21~~***36d*** of ~~section 220~~***SAS No. 146***.

[No further amendment to section 940.]

10. This amendment is effective for integrated audits for periods beginning on or after December 15, 2025.

Amendments to Various Sections in SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 700, Forming an Opinion and Reporting on Financial Statements

[No amendment to paragraphs .01–.A38.]

.A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those ~~pertaining~~***relating*** to independence, in a group audit situation may be complex. Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,[fn 21] provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

[No amendment to paragraphs .A40-.A53.]

.A54 ***Statement on Auditing Standards (SAS) No. 146,*** ~~Section 220,~~*Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires ***the following with regard to dating the auditor's report:***

- ~~that,~~ ***O***n or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, ***is required to*** ~~be satisfied~~ ***determine*** that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[fn 26]
- ***Prior to dating the auditor's report, the engagement partner is required to review the financial statements and the auditor's report, including, if***

applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances. *fn 27*

- When an engagement quality ~~control~~ review is performed, ~~section 220~~ the ***engagement partner is precluded from releasing the*** auditor's report ~~not be released prior to~~ ***until*** the completion of the engagement quality ~~control~~ review.[fn ~~27~~28]

fn 26 ~~See paragraph~~***Paragraph*** ~~19~~***32*** of ~~section 220,~~***SAS No. 146,*** *Quality ~~Control~~*__Management__ *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~, for further discussion~~.

fn 27 Paragraph 33 of SAS No. 146.

fn ~~27~~***28*** Paragraph ~~21~~***36d*** of ~~section 220~~***SAS No. 146***.

[No further amendment to section 700.]

11. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor's Report

[No amendment to paragraphs .01–.A12.]

.A13 Certain sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.[fn 7] For example, there may be potential difficulties relating to the following:

   i. *Related party transactions.* In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.[fn 8]

   ii. *Limitations on the group audit.* For example, the group engagement team's access to information may be restricted.[fn 9]

fns 7–9 [Footnotes omitted for purposes of this standard.]

b. ~~Section 220,~~***Statement on Auditing Standards No. 146,*** *Quality ~~Control~~*__Management__ *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters***, matters on which the firm's policies or procedures***

> ***require consultation, and other matters that, in the engagement partner's professional judgment, require consultation.***[fn 10] For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters ***and significant judgments*** arising during the audit engagement with the engagement quality ~~control~~ reviewer.

fn 10 Paragraph ~~20~~***35*** of ~~section 220,~~***SAS No. 146,*** *Quality ~~Control~~***Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[No amendment to paragraphs .A14–.A59.]

Communication With Those Charged With Governance (Ref: par. .16)

.A60 SAS No. 146 requires the engagement partner, prior to dating the auditor's report, to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.[fn 19]

fn 19 Paragraph 33 of SAS No. 146.

[No amendment to paragraph .A60, renumbered as paragraph .A61.]

.A6~~1~~*2* The requirement in paragraph .16*b* to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality ~~control~~ reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

[No amendment to paragraph .A62, renumbered as .A63.]

12. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

[No amendment to paragraphs .01–.A118.]

Date of the Auditor's Report (Ref: par. .82 and .126)

.A119 ***SAS No. 146,*** ~~Section 220,~~ *Quality* ~~*Control*~~ **Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires ***the following with regard to dating the auditor's report:***

- ~~that,~~ ***O***n or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, ***is required to*** ~~be satisfied~~ ***determine*** that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[fn 44]

- ***Prior to dating the auditor's report, the engagement partner is required to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.***[fn 45]

- When an engagement quality control review is performed, ~~section 220~~ the ***engagement partner is precluded from releasing the*** auditor's report ~~not be released prior to~~***until*** the completion of the engagement quality control review.[fn ~~45~~46]

fn 44 ~~See paragraph~~***Paragraph*** ~~19~~***32*** of ~~section 220,~~***SAS No. 146,*** *Quality* ~~*Control*~~**Management** *for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*~~, for further discussion~~.

fn 45 ***Paragraph 33 of SAS No. 146.***

fn ~~45~~46 Paragraph ~~21~~***36*****d** of ~~section 220~~***SAS No. 146***.

[No further amendment to section 703.]

13. This amendment is effective for audits of ERISA plan financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 720, *Other Information Included in Annual Reports*

[No amendment to paragraphs .01–.A26.]

.A27 In accordance with ~~section 220,~~***Statement on Auditing Standards No. 146,*** *Quality* ~~*Control*~~**Management** *for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*,[fn 8] the engagement partner is required to take responsibility for the direction~~,~~***and*** supervision~~, and performance of the audit engagement~~***of the members of the engagement team and the review of their work, and determine that the nature, timing, and extent of direction, supervision, and review is planned and performed*** in compliance with ***the firm's policies or procedures,*** professional standards***,***

and applicable legal and regulatory requirements.***fn 8*** In the context of this section, factors that may be considered when determining the appropriate engagement team members to address the requirements of paragraphs .16–.17 of this section include the following:

- The relative experience of engagement team members.
- Whether the engagement team members have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge.
- The degree of judgment involved in addressing the requirements of paragraphs .16–.17 of this section. For example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members.
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component.

fn 8 Paragraph***s*** ~~17*a*.~~***29–30*** of ~~section 220~~ ***SAS No. 146,*** *Quality* ~~*Control*~~ **Management** *for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*.

[No further amendment to section 720.]

14. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 142, *Audit Evidence*

Appendix B — Amendments to Various Sections in Statement on Auditing Standards No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

.A68

…

AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

.A27 Unconscious or conscious auditor biases may affect the auditor's professional skepticism and professional judgment, including, for example, in the design and performance of audit procedures or the evaluation of audit evidence. Examples of unconscious auditor biases **are provided in paragraph .A35 of Statement on Auditing Standards No. 146, *Quality Management of an Audit Conducted in Accordance With Generally Accepted Auditing Standards.*** ~~***that may impede the maintenance of professional skepticism and, therefore, the reasonableness of the professional judgments made by the auditor in complying with the requirements of this section, may include the following:***~~

- ~~**Availability bias, *which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not***~~
- ~~**Confirmation bias, *which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief***~~
- ~~**Overconfidence bias, *which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions***~~
- ~~**Anchoring bias, *which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed***~~
- ~~**Automation bias, *which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose***~~

[Paragraphs .A27–.A86 have been renumbered.]

15. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, Section 105, *Concepts Common to All Attestation Engagements*

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AT-C Section 105, *Concepts Common to All Attestation Engagements*

[No amendment to paragraphs .01–.05.]

Relationship of Attestation Standards to Quality Control Standards

.06 Quality ~~control~~***management*** systems, policies, and procedures are the responsibility of the firm in conducting its attestation practice. Under ~~QC section 10~~ ***Statement on Quality Management Standards No. 1,*** *A Firm's System of Quality* ~~*Control*~~**Management**, the firm has an obligation to ~~establish~~ ***design, implement,*** and ~~maintain~~***operate*** a system of quality ~~control~~***management*** ~~to provide it~~ ***that provides the firm*** with reasonable assurance that[fn 5] (Ref: par. .A4–.A6)

a. the firm and its personnel ~~comply~~***fulfill their responsibilities in accordance*** with professional standards and applicable legal and regulatory requirements ***and conduct attestation engagements in accordance with such standards and requirements,*** and

b. practitioners' reports issued by the firm are appropriate in the circumstances.

fn 5 Paragraph ~~12~~***20*** of ~~QC section 10,~~***Statement on Quality Management StandardsNo. 1***, *A Firm's System of Quality* ~~*Control*~~ **Management** ~~(AICPA, *Professional Standards*)~~.

.07 Attestation standards relate to the conduct of individual attestation engagements; quality ~~control~~***management*** standards relate to the conduct of a firm's attestation practice as a whole. Thus, attestation standards and quality ~~control~~***management*** standards are related, and the quality ~~control~~***management*** policies and procedures that ~~a~~ ***the*** firm ~~adopts~~ ***establishes*** may affect both the conduct of individual attestation engagements and the conduct of a ***the*** firm's attestation practice as a whole. However, deficiencies in or instances of noncompliance with ~~a~~***the*** firm's quality ~~control~~***management*** policies and procedures do not, in and of themselves, indicate that a particular engagement was not ~~performed~~***conducted*** in accordance with the attestation standards.

[No further amendment to AT-C section 105.]

16. This amendment is effective for practitioners' reports dated on or after December 15, 2025.

AU-C Section 220A

Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards

Source: SAS No. 122; SAS No. 128; SAS No. 134; SAS No. 136.

Effective for engagements conducted in accordance with generally accepted auditing standards for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, when applicable, the responsibilities of the engagement quality control reviewer. This section also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with section 930, *Interim Financial Information*). This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

.02 Although Statements on Quality Control Standards are not applicable to auditors in government audit organizations, this section is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.[1]

System of Quality Control and the Role of the Engagement Teams

.03 Quality control systems, policies, and procedures are the responsibility of the audit firm. Under QM section 10A, *A Firm's System of Quality Control*, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that[2]

a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and

[1] Paragraph .02 of QM section 10A, *A Firm's System of Quality Control*.

[2] Paragraph .12 of QM section 10A.

b. reports issued by the firm are appropriate in the circumstances. (Ref: par. .A1)

.04 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

.05 Engagement teams are entitled to rely on the firm's system of quality control, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties. (Ref: par. .A2)

.06 The engagement partner may use the assistance of other members of the engagement team or other personnel within the firm in meeting the requirements of this section. The requirements imposed by this section on engagement partners do not relieve other members of the engagement team of any of their professional responsibilities.

Effective Date

.07 This section is effective for engagements conducted in accordance with GAAS for periods ending on or after December 15, 2012.

Objective

.08 The objective of the auditor[3] is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that

a. the audit complies with professional standards and applicable legal and regulatory requirements and

b. the auditor's report issued is appropriate in the circumstances.

Definitions

.09 For purposes of GAAS, the following terms have the meanings attributed as follows:

Engagement partner.[4] The partner or other person in the firm who is responsible for the audit engagement and its performance and for the auditor's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is only for those audit engagements, if any, for which the firm

[3] See paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for the definition of *auditor*.

[4] *Engagement partner*, *partner*, and *firm* refer to their governmental equivalents, when relevant.

has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the auditor's report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external specialist engaged by the firm or a network firm.[5]

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, *Using the Work of Internal Auditors*.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET section 0.400, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which consist of the AICPA Code

[5] Paragraph .06 of section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Leadership Responsibilities for Quality on Audits

.10 The engagement partner should take responsibility for the overall quality on each audit engagement to which that partner is assigned. In fulfilling this responsibility, the engagement partner may delegate the performance of certain procedures to, and use the work of, other members of the engagement team and may rely upon the firm's system of quality control. (Ref: par. .A3)

Relevant Ethical Requirements

.11 Throughout the audit engagement, the engagement partner and other members of the engagement team should remain alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team. (Ref: par. .A4)

.12 If matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm as appropriate, should determine that appropriate action has been taken.

Independence

.13 The engagement partner should form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner should

a. obtain relevant information from the firm and, when applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence;

b. evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

c. take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the audit engagement when withdrawal is possible under applicable law or regulation. The engagement partner should promptly report to the firm any inability to resolve the matter so that the firm may take appropriate action. (Ref: par. .A5–.A6)

Acceptance and Continuance of Client Relationships and Audit Engagements

.14 The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and should determine that conclusions reached in this regard are appropriate. (Ref: par. .A7–.A8)

.15 If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm so that the firm and the engagement partner can take the necessary action. (Ref: par. .A8)

Assignment of Engagement Teams

.16 The engagement partner should be satisfied that the engagement team and any auditor's external specialists, collectively, have the appropriate competence and capabilities to

a. perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements and

b. enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: par. .A9–.A11)

Engagement Performance

Direction, Supervision, and Performance

.17 The engagement partner should take responsibility for the following:

a. The direction, supervision, and performance of the audit engagement in compliance with professional standards, applicable legal and regulatory requirements, and the firm's policies and procedures (Ref: par. .A12–.A14 and .A19)

b. The auditor's report being appropriate in the circumstances

Review

.18 The engagement partner should take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: par. .A15–.A16 and .A19)

.19 On or before the date of the auditor's report, the engagement partner should, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: par. .A17–.A19)

Consultation

.20 The engagement partner should

a. take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;

b. be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;

c. be satisfied that the nature and scope of such consultations are agreed with, and conclusions resulting from such consultations are understood by, the party consulted; and

d. determine that conclusions resulting from such consultations have been implemented. (Ref: par. .A20–.A22)

Engagement Quality Control Review

.21 For those audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner should

a. determine that an engagement quality control reviewer has been appointed;

b. discuss significant findings or issues arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and

c. not release the auditor's report until the completion of the engagement quality control review. (Ref: par. .A23–.A25)

.22 The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. This evaluation should involve

a. discussion of significant findings or issues with the engagement partner;

b. reading the financial statements and the proposed auditor's report;

c. review of selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached; and

d. evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: par. .A26–.A32)

Differences of Opinion

.23 If differences of opinion arise within the engagement team; with those consulted; or, when applicable, between the engagement partner and the engagement quality control reviewer, the engagement team should follow the firm's policies and procedures for resolving differences of opinion.

Monitoring

.24 An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner should consider

a. the results of the firm's monitoring process as evidenced in the latest information circulated to the engagement partner by the firm and, if applicable, other network firms and

b. whether deficiencies noted in that information may affect the audit engagement. (Ref: par. .A32–.A34)

Documentation

.25 The auditor should include in the audit documentation the following:[6] (Ref: par. .A35)

a. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved

b. Conclusions on compliance with independence requirements that apply to the audit engagement and any relevant discussions with the firm that support these conclusions

c. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements

d. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement (Ref: par. .A36)

.26 The engagement quality control reviewer should document, for the audit engagement reviewed

a. that the procedures required by the firm's policies on engagement quality control review have been performed;

b. the date that the engagement quality control review was completed; and

[6] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

c. that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

Application and Other Explanatory Material

System of Quality Control and the Role of the Engagement Teams (Ref: par. .02)

.A1 QM section 10A addresses the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

Reliance on the Firm's System of Quality Control (Ref: par. .05)

.A2 Unless information provided by the firm or other parties suggests otherwise, the engagement team may rely on the firm's system of quality control regarding, for example

- competence of personnel through their recruitment and formal training.
- independence through the accumulation and communication of relevant independence information.
- maintenance of client relationships through acceptance and continuance systems.
- adherence to applicable legal and regulatory requirements through the monitoring process.

Leadership Responsibilities for Quality on Audits (Ref: par. .10)

.A3 The engagement partner's actions and communications with the other members of the engagement team demonstrate responsibility for the overall quality on each audit engagement when they emphasize

a. the importance to audit quality of
   i. performing work that complies with professional standards and applicable legal and regulatory requirements;

ii. complying with the firm's applicable quality control policies and procedures;

iii. issuing auditor's reports that are appropriate in the circumstances; and

iv. the engagement team's ability to raise concerns without fear of reprisals and

b. the fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements

Compliance With Relevant Ethical Requirements (Ref: par. .11)

.A4 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care

Threats to Independence (Ref: par. .13)

.A5 The engagement team may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph .13*c*, the engagement partner reports to the relevant person(s) within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat or withdrawing from the audit engagement when withdrawal is possible under applicable law or regulation.

Considerations Specific to Governmental Entities

.A6 Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors employed by them. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. .14)

.A7 QM section 10A requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.[7] Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management, and those charged with governance of the entity
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources
- Whether the firm and the engagement team can comply with relevant ethical requirements
- Significant findings or issues that have arisen during the current or previous audit engagement and their implications for continuing the relationship

Considerations Specific to Governmental Entities (Ref: par. .14–.15)

.A8 For some governmental entities, auditors may be appointed in accordance with law or regulation, and the auditor may not be permitted to decline or withdraw from the engagement. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs .14–.15 and .A7 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable in planning the audit, performing risk assessments, and carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: par. .16)

.A9 A person with expertise in a specialized area of accounting or auditing is a member of the engagement team if that person performs audit procedures on the engagement. This applies whether that person is an employee of the firm or a nonemployee engaged by the firm. However, a person with such expertise is not a member of the engagement team if that person's involvement with the engagement is only consultation. Consultations are addressed in paragraphs .20 and .A20–.A22.

.A10 When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant IT and specialized areas of accounting or auditing.
- knowledge of relevant industries in which the entity operates.

[7] Paragraph .27 of QM section 10A.

- ability to apply professional judgment.
- understanding of the firm's quality control policies and procedures.

Considerations Specific to Governmental Entities (Ref: par. .16)

.A11 For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation. Such competence may include knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect on the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance.

Engagement Performance

Direction, Supervision, and Performance (Ref: par. .17a)

.A12 Direction of the engagement team involves informing the members of the engagement team of matters such as the following:

- Their responsibilities, including the need to comply with relevant ethical requirements and to plan and perform an audit with professional skepticism as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*[8]
- Responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement
- The objectives of the work to be performed
- The nature of the entity's business
- Risk-related issues
- Problems that may arise
- The detailed approach to the performance of the engagement

Discussion among members of the engagement team allows team members to raise questions so that appropriate communication can occur within the engagement team.

.A13 Appropriate teamwork and training assist members of the engagement team to clearly understand the objectives of the assigned work.

.A14 Supervision includes matters such as the following:

[8] Paragraphs .16–.17 of section 200.

- Tracking the progress of the audit engagement
- Considering the competence and capabilities of individual members of the engagement team, including whether they have sufficient time to carry out their work, they understand their instructions, and the work is being carried out in accordance with the planned approach to the audit engagement
- Addressing significant findings or issues arising during the audit engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by qualified engagement team members during the audit engagement

Review

Review Responsibilities (Ref: par. .18)

.A15 Under QM section 10A, the firm's review responsibility policies and procedures are determined on the basis that suitably experienced team members review the work of other team members.[9] The engagement partner may delegate part of the review responsibility to other members of the engagement team, in accordance with the firm's system of quality control.

.A16 A review consists of consideration of whether, for example

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings or issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the auditor's report; and
- the objectives of the engagement procedures have been achieved.

The Engagement Partner's Review of the Work Performed (Ref: par. .19)

.A17 Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant findings or issues to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report:

[9] Paragraph .36 of QM section 10A.

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement
- Significant risks
- Other areas that the engagement partner considers important

The engagement partner need not review all audit documentation but may do so. However, as required by section 230, *Audit Documentation*, the partner documents the extent and timing of the reviews.[10]

.A18 An engagement partner taking over an audit during the engagement may apply the review procedures as described in paragraph .A17 to review the work performed to the date of the change in order to assume the responsibilities of an engagement partner.

Considerations Relevant When a Member of the Engagement Team With Expertise in a Specialized Area of Accounting or Auditing Is Used (Ref: par. .17–.19)

.A19 When the engagement team includes a member with expertise in a specialized area of accounting or auditing, direction, supervision, and review of that engagement team member's work is the same as for any other engagement team member and may include matters such as the following:

- Agreeing with that member upon the nature, scope, and objectives of that member's work and the respective roles of, and the nature, timing, and extent of communication between, that member and other members of the engagement team
- Evaluating the adequacy of that member's work, including the relevance and reasonableness of that member's findings or conclusions and the consistency of those findings or conclusions with other audit evidence

Consultation (Ref: par. .20)

.A20 Members of the engagement team have a professional responsibility to bring to the attention of appropriate personnel matters that, in their professional judgment, are difficult or contentious and may require consultation.

.A21 Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience.

.A22 The engagement team may consult outside the firm (for example, when the firm lacks appropriate internal resources). The engagement team may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

[10] Paragraph .09*c* of section 230.

Engagement Quality Control Review

Completion of the Engagement Quality Control Review Before Releasing the Auditor's Report (Ref: par. .21c)

.A23 Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant findings or issues to be promptly resolved to the engagement quality control reviewer's satisfaction.

.A24 *Completion of the engagement quality control review* means the completion by the engagement quality control reviewer of the requirements in paragraph .22 and, when applicable, compliance with paragraph .23. Documentation of the engagement quality control review may be completed after the report release date as part of the assembly of the final audit file. Section 230 establishes requirements and provides guidance in this regard.[11]

.A25 When the engagement quality control review is completed after the auditor's report is dated and identifies instances where additional procedures or additional evidence is necessary, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Nature, Timing, and Extent of Engagement Quality Control Review (Ref: par. .22)

.A26 By remaining alert for changes in circumstances, the engagement partner is able to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement such a review was not required.

.A27 The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement and the risk that the auditor's report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner for the audit engagement and its performance.

.A28 When section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the conclusions reached by the engagement team in formulating the auditor's report include determining the following:

- The key audit matters to be communicated
- The key audit matters that will not be communicated in the auditor's report in accordance with paragraph .13 of section 701, if any
- If applicable, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate in the auditor's report

[11] Paragraphs .15–.18 and .A24–.A29 of section 230.

In addition, the reading of the proposed auditor's report in accordance with paragraph .22*b* includes consideration of the proposed descriptions of the matters to be included in the "Key Audit Matters" section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A29 Matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review include the following:

- Significant risks identified during the engagement in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and the responses to those risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, including the engagement team's assessment of, and response to, the risk of fraud in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the audit
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A30 The engagement quality control reviewer may also consider the following:

- The evaluation of the firm's independence with regard to the audit engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the related conclusions arising from those consultations
- Whether audit documentation selected for review reflects the work performed regarding the significant judgments and supports the conclusions reached

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .21–.22)

.A31 An engagement quality control review is required for audit engagements that meet the criteria established by the firm that subjects engagements to an engagement quality control review. In some cases, none of the firm's audit engagements may meet the criteria that would subject them to such a review. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities (Ref: par. .22)

.A32 A statutorily appointed auditor (for example, an auditor general or other suitably qualified person within the audit organization acting on behalf of the auditor general) may act in a role equivalent to that of engagement partner with overall responsibility for the governmental audit. In such circumstances, when applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Monitoring (Ref: par. .24)

.A33 QM section 10A requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.[12] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A34 In considering deficiencies that may affect the audit engagement, the engagement partner may consider measures the firm took to rectify the situation that the engagement partner considers sufficient in the context of that audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A35 A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .25)

.A36 Section 230 addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements. Section 230 also states that it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.[13] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A37 Documentation of consultations with other professionals involving difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

[12] Paragraph .52 of QM section 10A.

[13] Paragraph .A9 of section 230.

AU-C Section 230

Audit Documentation

Source: SAS No. 122; SAS No. 123; SAS No. 128; SAS No. 134; SAS No. 137; SAS No. 142; SAS No. 143; SAS No. 145.

See section 9230 for interpretations of this section.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements. The exhibit, "Audit Documentation Requirements in Other AU-C Sections," lists other AU-C sections that contain specific documentation requirements and guidance. The specific documentation requirements of other AU-C sections do not limit the application of this section. Law, regulation, or other standards may establish additional documentation requirements.

Nature and Purposes of Audit Documentation

.02 Audit documentation that meets the requirements of this section and the specific documentation requirements of other relevant AU-C sections provides

a. evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor;[1] and

b. evidence that the audit was planned and performed in accordance with generally accepted auditing standards (GAAS) and applicable legal and regulatory requirements.

.03 Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work and to discharge their review responsibilities in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*[2]
- Enabling the engagement team to demonstrate that it is accountable for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retaining a record of matters of continuing significance to future audits of the same entity
- Enabling the conduct of quality control reviews and inspections in accordance with QM section 10A, *A Firm's System of Quality Control*
- Enabling the conduct of external inspections or peer reviews in accordance with applicable legal, regulatory, or other requirements
- Assisting an auditor who reviews a predecessor auditor's audit documentation
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

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[1]Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraphs .17–.19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Objective

.05 The objective of the auditor is to prepare documentation that provides

a. a sufficient and appropriate record of the basis for the auditor's report; and

b. evidence that the audit was planned and performed in accordance with GAAS and applicable legal and regulatory requirements.

Definitions

.06 For purposes of GAAS, the following terms have the meanings attributed as follows:

Audit documentation. The record of audit procedures performed, audit evidence obtained, and conclusions the auditor reached (terms such as *working papers* or *workpapers* are also sometimes used).

Audit file. One or more folders or other storage media, in physical or electronic form, containing the records that constitute the audit documentation for a specific engagement.

Documentation completion date. The date, no later than 60 days following the report release date, on which the auditor has assembled for retention a complete and final set of documentation in an audit file.

Experienced auditor. An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of (Ref: par. .A1)

a. audit processes;

b. GAAS and applicable legal and regulatory requirements;

c. the business environment in which the entity operates; and

d. auditing and financial reporting issues relevant to the entity's industry.

Report release date. The date the auditor grants the entity permission to use the auditor's report in connection with the financial statements. (Ref: par. .A2)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Requirements

Timely Preparation of Audit Documentation

.07 The auditor should prepare audit documentation on a timely basis. (Ref: par. .A3)

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content, and Extent of Audit Documentation

.08 The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand (Ref: par. .A4–.A7 and .A19–.A20)

a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements; (Ref: par. .A8–.A9)

b. the results of the audit procedures performed, and the audit evidence obtained; and

c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: par. .A10–.A13)

.09 In documenting the nature, timing, and extent of audit procedures performed, the auditor should record

a. the identifying characteristics of the specific items or matters tested; (Ref: par. .A14)

b. who performed the audit work and the date such work was completed; and

c. who reviewed the audit work performed and the date and extent of such review. (Ref: par. .A15)

.10 For audit procedures related to the inspection of significant contracts or agreements, the auditor should include abstracts or copies of those contracts or agreements in the audit documentation.

.11 The auditor should document discussions of significant findings or issues with management, those charged with governance, and others, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place. (Ref: par. .A16)

.12 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. (Ref: par. .A17–.A18)

Departure From a Relevant Requirement

.13 If, in rare circumstances, the auditor judges it necessary to depart from a relevant presumptively mandatory requirement,[3] the auditor must document the justification for the departure and how the alternative audit procedures performed in the circumstances were sufficient to achieve the intent of that requirement. (Ref: par. .A21–.A22)

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[3] Paragraph .26 of section 200.

Matters Arising After the Date of the Auditor's Report

.14 If, in rare circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor should document (Ref: par. .A23)

a. the circumstances encountered;

b. the new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and

c. when and by whom the resulting changes to audit documentation were made and reviewed.

Assembly and Retention of the Final Audit File

.15 The auditor should document the report release date in the audit documentation.

.16 The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date. (Ref: par. .A24–.A26)

.17 After the documentation completion date, the auditor should not delete or discard audit documentation of any nature before the end of the specified retention period. Such retention period, however, should not be shorter than five years from the report release date. (Ref: par. .A27–.A29)

.18 In circumstances other than those addressed in paragraph .14 in which the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the documentation completion date, the auditor should, regardless of the nature of the modifications or additions, document (Ref: par. .A28)

a. the specific reasons for making the changes; and

b. when and by whom they were made and reviewed.

.19 The auditor should adopt reasonable procedures to maintain the confidentiality of client information.

Application and Other Explanatory Material

Definitions (Ref: par. .06)

Experienced Auditor

.A1 Having practical audit experience means possessing the competencies and skills that would have enabled the auditor to perform the audit but does not mean that the auditor is required to have performed comparable audits.

Report Release Date

.A2 In many cases, the report release date will be the date the auditor delivers the audit report to the entity. When there are delays in releasing the report, a fact may become known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report. Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities in such circumstances, and paragraph .14 addresses the documentation requirements in the rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report.

Timely Preparation of Audit Documentation (Ref: par. .07)

.A3 Preparing sufficient and appropriate audit documentation on a timely basis throughout the audit helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared at the time such work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content, and Extent of Audit Documentation (Ref: par. .08)

.A4 The form, content, and extent of audit documentation depend on factors such as

- the size and complexity of the entity.
- the nature of the audit procedures to be performed.
- the identified risks of material misstatement.
- the significance of the audit evidence obtained.
- the nature and extent of exceptions identified.
- the need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- the audit methodology and tools used.
- the extent of judgment involved in performing the work and evaluating the results.

.A5 Audit documentation may be recorded on paper or on electronic or other media. QM section 10A addresses a firm's responsibility to establish procedures designed to maintain the integrity, accessibility, and retrievability of documentation; for example, when original paper documentation is electronically scanned or otherwise copied to another media for inclusion in the audit file.[4] Examples of audit documentation include the following:

- Audit plans[5]
- Analyses
- Issues memorandums
- Summaries of significant findings or issues
- Letters of confirmation and representation
- Checklists
- Correspondence (including e-mail) concerning significant findings or issues

.A6 The auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A7 On their own, oral explanations by the auditor do not represent adequate support for the work the auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation.

Documentation of Compliance With GAAS (Ref: par. .08a)

.A8 In principle, compliance with the requirements of this section will result in the audit documentation being sufficient and appropriate in the circumstances. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of this section in the particular circumstances of those other AU-C sections. The specific documentation requirements of other AU-C sections do not limit the application of this section. Furthermore, the absence of a documentation requirement in any particular AU-C section is not intended to suggest that there is no documentation that will be prepared as a result of complying with that AU-C section.

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.

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[4]Paragraph .A58 of QM section 10A, *A Firm's System of Quality Control*.

[5]Paragraphs .07–.11 of section 300, *Planning an Audit*.

- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.

- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

  — For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with GAAS, for example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, documenting how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion about the sufficiency and appropriateness of the audit evidence obtained.

  — Similarly, that the engagement partner has taken responsibility for the direction, supervision, and performance of the audit in compliance with GAAS may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.[6]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Documentation of Significant Findings or Issues and Related Significant Professional Judgments (Ref: par. .08c)

.A10 Judging the significance of a finding or issue requires an objective analysis of the facts and circumstances. Examples of significant findings or issues include

- matters involving the selection, application, and consistency of significant accounting practices, including related disclosures. Such matters include, but are not limited to (*a*) accounting for complex or unusual transactions or (*b*) accounting estimates and uncertainties and, if applicable, the related management assumptions.

- matters that give rise to significant risks (as defined in section 315).[7]

- results of audit procedures (including identification of corrected and uncorrected misstatements)[8] indicating (*a*) that the financial statements could be materially

[6]Paragraph .33 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[7]Paragraphs .28–.30 of section 315.

[8]See section 450, *Evaluation of Misstatements Identified During the Audit*.

misstated or (*b*) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.

- circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- findings that could result in a modification to the audit opinion or the inclusion of an emphasis-of-matter paragraph in the auditor's report.

.A11 An important factor in determining the form, content, and extent of audit documentation of significant findings or issues is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, when significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such findings or issues are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing items of continuing significance (for example, when performing a retrospective review of accounting estimates).

.A12 Some examples of circumstances in which, in accordance with paragraph .08, it is appropriate to prepare audit documentation relating to the exercise of professional judgment include, when the findings, issues, and judgments are significant,

- the rationale for the auditor's conclusion when a requirement provides that the auditor *should consider* certain information or factors, and that consideration is significant in the context of the particular engagement.
- the basis for the auditor's conclusion on the reasonableness of areas of subjective judgments made by management.
- the basis for the auditor's evaluation of whether an accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.
- the basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of a specialist or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the auditor's determination of the key audit matters or the determination that there are no key audit matters to be communicated, including in the extremely rare circumstances in which the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A13 The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant findings or issues identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant findings or issues. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant AU-C section objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Identification of Specific Items or Matters Tested and of the Preparer and the Reviewer (Ref: par. .09)

.A14 Recording the identifying characteristics serves a number of purposes. For example, it improves the ability of the auditor to supervise and review the work performed and thus demonstrates the accountability of the engagement team for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested. For example:

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
- For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register for the period being audited).
- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point, and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period from April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the inquiries made, the dates of the inquiries, and the names and job designations of the entity personnel.
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.

.A15 Section 220A requires the auditor to review the audit work performed through review of the audit documentation.[9] The requirement to document who reviewed the audit work performed and the extent of the review, in accordance with the firm's policies and procedures addressing review responsibilities, does not imply a need for each specific

[9]Paragraph .19 of section 220A.

working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

Documentation of Discussions of Significant Findings or Issues With Management, Those Charged With Governance, and Others (Ref: par. .11)

.A16 The audit documentation is not limited to documents prepared by the auditor but may include other appropriate documents such as minutes of meetings prepared by the entity's personnel and recognized by the auditor as an appropriate summary of the meeting. Others with whom the auditor may discuss significant findings or issues may include other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

Documentation of How Inconsistencies Have Been Addressed (Ref: par. .12)

.A17 The requirement to document how the auditor addressed inconsistencies in information does not imply that the auditor needs to retain documentation that is incorrect or superseded.

.A18 The documentation of the inconsistency may include, but is not limited to, procedures performed in response to the information, and documentation of consultations on, or resolutions of, differences in professional judgment among members of the engagement team or between the engagement team and others consulted.

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .08)

.A19 The audit documentation for the audit of a smaller, less complex entity is generally less extensive than that for the audit of a larger, more complex entity. Further, in the case of an audit in which the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision). Nevertheless, the engagement partner complies with the overriding requirement in paragraph .08 to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes.

.A20 When preparing audit documentation, the auditor of a smaller, less complex entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller, less complex entity include the understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control; the overall audit strategy and audit plan; materiality; assessed risks, significant findings or issues noted during the audit; and conclusions reached. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Departure From a Relevant Requirement (Ref: par. .13)

.A21 The requirements of GAAS are designed to enable the auditor to achieve the objectives specified in GAAS, and thereby the overall objectives of the auditor. Accordingly, other than in rare circumstances, GAAS call for compliance with each requirement that is relevant in the circumstances of the audit.

.A22 The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant[10] only in the cases in which

a. the AU-C section is not relevant (for example, if an entity does not have an internal audit function, nothing in section 610, *Using the Work of Internal Auditors*, is relevant); or

b. the requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor's opinion when there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability).

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Matters Arising After the Date of the Auditor's Report (Ref: par. .14)

.A23 Examples of rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report include

- when, after the date of the auditor's report, the auditor becomes aware of facts that existed at that date and which, if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor's report.[11]
- when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial information.[12]

The resulting changes to the audit documentation are reviewed in accordance with the firm's quality control procedures as required by QM section 10A.

Assembly and Retention of the Final Audit File (Ref: par. .16–.18)

.A24 Statutes, regulations, or the audit firm's quality control policies may specify a period of time shorter than 60 days following the report release date in which this assembly process is to be completed.

[10] Paragraph .24 of section 200.

[11] Paragraphs .12 and .15 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[12] Paragraph .07 of section 585, *Consideration of Omitted Procedures After the Report Release Date*.

.A25 Certain matters, such as auditor independence and staff training, which are not engagement specific, may be documented either centrally within a firm or in the audit documentation for an audit engagement.

.A26 The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include

- deleting or discarding superseded documentation.
- sorting, collating, and cross-referencing working papers.
- signing off on completion checklists relating to the file assembly process.
- documenting audit evidence that the auditor has obtained, discussed, and agreed with the relevant members of the engagement team before the date of the auditor's report.
- adding information received after the date of the auditor's report; for example, an original confirmation that was previously communicated electronically.

.A27 Firms are required to establish policies and procedures for the retention of engagement documentation.[13] Statutes, regulations, or the audit firm's quality control policies may specify a retention period longer than five years.

.A28 An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after the documentation completion date is the need to clarify existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties.

.A29 Audit documentation is the property of the auditor, and some states recognize this right of ownership in their statutes. The auditor may make available to the entity at the auditor's discretion copies of the audit documentation, provided such disclosure does not undermine the effectiveness and integrity of the audit process.

[13] Paragraph .50 of QM section 10A.

Exhibit — Audit Documentation Requirements in Other AU-C Sections

.A30 The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

a. Paragraphs .10, .13, and .16 of section 210A, *Terms of Engagement*

b. Paragraphs .25–.26 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*

c. Paragraphs .43–.46 of section 240, *Consideration of Fraud in a Financial Statement Audit*

d. Paragraph .28 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

e. Paragraph .20 of section 260, *The Auditor's Communication With Those Charged With Governance*

f. Paragraph .12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*

g. Paragraph .14 of section 300, *Planning an Audit*

h. Paragraph .33 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

i. Paragraph .14 of section 320, *Materiality in Planning and Performing an Audit*

j. Paragraphs .30–.33 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

k. Paragraph .12 of section 450, *Evaluation of Misstatements Identified During the Audit*

l. Paragraph .20 of section 501, *Audit Evidence — Specific Considerations for Selected Items*

m. Paragraph .08 of section 520, *Analytical Procedures*

n. Paragraph .38 of section 540, *Auditing Accounting Estimates and Related Disclosures*

o. Paragraph .28 of section 550, *Related Parties*

p. Paragraph .22 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

q. Paragraphs .49 and .64 of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

r. Paragraphs .33–.35 of section 610, *Using the Work of Internal Auditors*

s. Paragraph .17 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

t. Paragraph .26 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

u. Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*

v. Paragraphs .42–.43 of section 930, *Interim Financial Information*

w. Paragraphs .39–.42 of section 935, *Compliance Audits*

[Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

AU-C Section 9230

Audit Documentation: Auditing Interpretations of Section 230

1. Providing Access to or Copies of Audit Documentation to a Regulator[1,2]

.01 *Question*—Paragraph .19 of section 230, *Audit Documentation*, states that "the auditor should adopt reasonable procedures to maintain the confidentiality of client information." However, auditors are sometimes required by law, regulation, or audit contract[3] to provide a regulator, or a duly appointed representative, access to audit documentation. For example, a regulator may request access to the audit documentation to fulfill a quality review requirement or to assist in establishing the scope of a regulatory examination. Furthermore, as part of the regulator's review of the audit documentation, the regulator may request copies of all or selected portions of the audit documentation during or after the review. The regulator may intend, or decide, to make copies (or information derived from the audit documentation) available to others, including other governmental agencies, for their particular purposes, with or without the knowledge of the auditor or the client. When a regulator requests the auditor to provide access to (and possibly copies of) audit documentation pursuant to law, regulation, or audit contract, what steps may the auditor take?

.02 *Interpretation*—When a regulator requests access to audit documentation pursuant to law, regulation, or audit contract, the auditor may take the following steps:

a. Consider advising the client that the regulator has requested access to (and possibly copies of) the audit documentation and that the auditor intends to comply with such request.[4]

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[1]The term *regulator(s)* includes federal, state, and local government officials with legal oversight authority over the entity. Examples of regulators who may request access to audit documentation include, but are not limited to, state insurance and utility regulators, various health care authorities, and federal agencies such as the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the Department of Labor, and the Rural Electrification Administration.

[2]The guidance in this interpretation does not apply to requests from the IRS, firm practice-monitoring programs to comply with AICPA or state professional requirements such as peer or quality reviews, proceedings relating to alleged ethics violations, or subpoenas.

[3]Paragraphs .11–.15 of this interpretation address situations in which the auditor is not required by law, regulation, or audit contract to provide a regulator access to the audit documentation.

[4]The auditor may wish (and in some cases may be required by law, regulation, or audit contract) to confirm in writing with the client that the auditor may be required to provide a regulator access to the audit documentation. Sample language that may be used follows:

b. Make appropriate arrangements with the regulator for the review.

c. Maintain control over the audit documentation, and

d. Consider submitting the letter described in paragraph .05 of this interpretation to the regulator.

.03 Making appropriate arrangements with the regulator may include establishing the specific details such as the date, time, and location of the review. The audit documentation may be made available to a regulator at the offices of the client, the auditor, or a mutually agreed-upon location. However, maintaining control of audit documentation is necessary in order for the auditor to maintain the integrity of the audit documentation and the confidentiality of client information. For example, the auditor (or the auditor's representative) may be present when the audit documentation is reviewed by the regulator.

.04 Ordinarily, the auditor may not agree to transfer ownership of the audit documentation to a regulator. Furthermore, the auditor may not agree, without client authorization, that the information contained therein about the client may be communicated to or made available to any other party. In this regard, the action of an auditor providing access to, or copies of, the audit documentation shall not constitute transfer of ownership or authorization to make them available to any other party.

.05 An audit performed in accordance with generally accepted auditing standards is not intended to, and does not, satisfy a regulator's oversight responsibilities. To avoid any misunderstanding, prior to allowing a regulator access to the audit documentation, the auditor may submit a letter to the regulator that

a. sets forth the auditor's understanding of the purpose for which access is being requested;

b. describes the audit process and the limitations inherent in a financial statement audit;

c. explains the purpose for which the audit documentation was prepared, and that any individual conclusions must be read in the context of the auditor's report on the financial statements;

d. states, except when not applicable, that the audit was not planned or conducted in contemplation of the purpose for which access is being granted or to assess the entity's compliance with laws and regulations;

The audit documentation for this engagement is the property of [*name of auditor*] and constitutes confidential information. However, we may be requested to make certain audit documentation available to [*name of regulator*] pursuant to authority given to it by law or regulation. If requested, access to such audit documentation will be provided under the supervision of [*name of auditor*] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to [*name of regulator*]. The [*name of regulator*] may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

e. states that the audit and the audit documentation should not supplant other inquiries and procedures that should be undertaken by the regulator for its purposes;

f. requests confidential treatment under the Freedom of Information Act or similar laws and regulations,[5] when a request for the audit documentation is made, and that written notice be given to the auditor before transmitting any information contained in the audit documentation to others, including other governmental agencies, except when such transfer is required by law or regulation; and

g. states that if any copies are to be provided, they will be identified as "Confidential Treatment Requested by [*name of auditor, address, telephone number*]."

The auditor may obtain a signed acknowledgment copy of the letter as evidence of the regulator's receipt of the letter.

.06 An example of a letter containing the elements described in paragraph .05 of this interpretation is presented as follows:

[5]The auditor may need to consult the regulations of individual agencies and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

Illustrative Letter to Regulator[6]

[*Date*]

[*Name and Address of Regulatory Agency*]

Your representatives have requested access to our audit documentation in connection with our audit of the December 31, 20XX, financial statements of [*name of client*]. It is our understanding that the purpose of your request is [*state purpose: for example, "to facilitate your regulatory examination"*].[7]

Our audit of [*name of client*] December 31, 20XX, financial statements was conducted in accordance with auditing standards generally accepted in the United States of America,[8] the objective[9] of which is to form an opinion as to whether the financial statements, which are the responsibility and representations of management, present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.[10] Under generally accepted auditing standards, we have the responsibility, within the inherent limitations of the auditing process, to design our audit to provide reasonable assurance that errors and fraud that have a material effect on the financial statements will be detected, and to exercise due care in the conduct of our audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and as to the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Thus, our audit, based on the concept of selective testing, is subject to the inherent risk that material errors or fraud, if they exist, would not be detected. In addition, an audit does not address the possibility that material errors or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may have existed that would have been assessed differently by you.

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[6]This letter may be modified appropriately when the audit has been performed in accordance with generally accepted auditing standards and also in accordance with additional auditing requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

[7]If the auditor is not required by law, regulation, or audit contract to provide a regulator access to the audit documentation but otherwise intends to provide such access (see paragraphs .11–.15 of this interpretation), the letter may include a statement that "Management of [*name of client*] has authorized us to provide you access to our audit documentation for [*state purpose*]."

[8]See footnote 6.

[9]In an audit performed in accordance with the Single Audit Act of 1984, the Single Audit Act Amendments of 1996, and certain other federal audit requirements, an additional objective of the audit is to assess compliance with laws and regulations applicable to federal financial assistance. Accordingly, in these situations, the illustrative letter provided in this interpretation may be modified to include the additional objective.

[10]If the financial statements have been prepared in conformity with regulatory accounting practices, the phrase "financial position, results of operations, and cash flows in conformity with generally accepted accounting principles" may be replaced with appropriate wording such as, in the case of an insurance company, the "admitted assets, liabilities ... of the XYZ Insurance Company in conformity with accounting practices prescribed or permitted by the state of ... insurance department."

The audit documentation was prepared for the purpose of providing a sufficient and appropriate record of the basis for our report on [*name of client*] December 31, 20XX, financial statements and to aid in the conduct and supervision of our audit. The audit documentation is the principal record of auditing procedures performed, evidence obtained, and conclusions reached in the engagement. The auditing procedures that we performed were limited to those we considered necessary under generally accepted auditing standards[11] to enable us to formulate and express an opinion on the financial statements[12] taken as a whole. Accordingly, we make no representation as to the sufficiency or appropriateness, for your purposes, of either the information contained in our audit documentation or our auditing procedures. In addition, any notations, comments, and individual conclusions appearing on any of the audit documents do not stand alone, and should not be read as an opinion on any individual amounts, accounts, balances or transactions.

Our audit of [*name of client*] December 31, 20XX, financial statements was performed for the purpose stated above and has not been planned or conducted in contemplation of your [*state purpose: for example, "regulatory examination"*] or for the purpose of assessing [*name of client*] compliance with laws and regulations.[13] Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our audit and the audit documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the [*name of regulatory agency*] for the purpose of monitoring and regulating the financial affairs of the [*name of client*]. In addition, we have not audited any financial statements of [*name of client*] since [*date of audited balance sheet referred to in the first paragraph above*] nor have we performed any auditing procedures since [*date*], the date of our auditor's report, and significant events or circumstances may have occurred since that date.

The audit documentation constitutes and reflects work performed or evidence obtained by [*name of auditor*] in its capacity as independent auditor for [*name of client*]. The documents contain trade secrets and confidential commercial and financial information of our firm and [*name of client*] that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations[14] when requests are made for the audit documentation or information contained therein or any documents created by the [*name of regulatory agency*] containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the audit documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.

[*If it is expected that copies will be requested, add:*

[11] See footnote 6.

[12] See footnote 9.

[13] See footnote 9.

[14] This illustrative paragraph may not in and of itself be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The auditor may tailor this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, may consult with legal counsel regarding the specific procedures and requirements to gain confidential treatment.

Any copies of our audit documentation we agree to provide you will be identified as "Confidential Treatment Requested by [*name of auditor, address, telephone number*]."]

[*Firm signature*]

.07 *Question*—A regulator may request access to the audit documentation before the audit has been completed and the report released. May the auditor allow access in such circumstances?

.08 *Interpretation*—When the audit has not been completed, the audit documentation is necessarily incomplete because (*a*) additional information may be added as a result of further tests and review by supervisory personnel and (*b*) any audit results and conclusions reflected in the incomplete audit documentation may change. Accordingly, it is preferable that access be delayed until all auditing procedures have been completed and all internal reviews have been performed. If access is provided prior to completion of the audit, the auditor may issue the letter referred to in paragraph .05 of this interpretation, appropriately modified, and including additional language along the following lines:

We have been engaged to audit in accordance with auditing standards generally accepted in the United States of America the December 31, 20XX, financial statements of XYZ Company, but have not as yet completed our audit. Accordingly, at this time we do not express any opinion on the Company's financial statements. Furthermore, the contents of the audit documentation may change as a result of additional auditing procedures and review of the audit documentation by supervisory personnel of our firm. Accordingly, our audit documentation is incomplete.

Because the audit documentation may change prior to completion of the audit, it is preferable that the auditor not provide copies of the audit documentation until the audit has been completed.

.09 *Question*—Some regulators may engage an independent party, such as another independent public accountant, to perform the audit documentation review on behalf of the regulatory agency. Are there any special precautions the auditor may observe in these circumstances?

.10 *Interpretation*—The auditor may obtain acknowledgment, preferably in writing, from the regulator stating that the third party is acting on behalf of the regulator and agreement from the third party that he or she is subject to the same restrictions on disclosure and use of audit documentation and the information contained therein as the regulator.

.11 *Question*—When a regulator requests the auditor to provide access to (and possibly copies of) audit documentation and the auditor is not otherwise required by law, regulation, or audit contract to provide such access, what steps may the auditor take?

.12 *Interpretation*—The auditor may obtain an understanding of the reasons for the regulator's request for access to the audit documentation and may consider consulting with legal counsel regarding the request. If the auditor decides to provide such access, reasonable procedures to maintain the confidentiality of client information include obtaining the client's consent, preferably in writing, to provide the regulator access to the audit documentation.

.13 Following is an example of language that may be used in the written communication to the client:

> The audit documentation for this engagement is the property of [*name of auditor*] and constitutes confidential information. However, we have been requested to make certain audit documentation available to [*name of regulator*] for [*describe the regulator's basis for its request*]. Access to such audit documentation will be provided under the supervision of [*name of auditor*] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to [*name of regulator*].
>
> You have authorized [*name of auditor*] to allow [*name of regulator*] access to the audit documentation in the manner discussed above. Please confirm your agreement to the above by signing below and returning to [*name of auditor, address*].
>
> [*Firm signature*]
>
> Agreed and acknowledged:
>
> [*Name and title*]
>
> [*Date*]

.14 If the client requests to review the audit documentation before allowing the regulator access, the auditor may provide the client with the opportunity to obtain an understanding of the nature of the information about its financial statements contained in the audit documentation that is being made available to the regulator. When a client reviews the audit documentation, the need to maintain control of the audit documentation is as discussed in paragraph .03 of this interpretation.

.15 The guidance in paragraphs .03–.10 of this interpretation, which provide guidance on making arrangements with the regulator for access to the audit documentation, maintaining control over the audit documentation, and submitting a letter describing various matters to the regulator, is also applicable.

[Issue Date: July, 1994; Revised: June, 1996; Revised: October, 2000; Revised: January, 2002; Revised: December, 2005; Revised: October, 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

AU-C Section 240

Consideration of Fraud in a Financial Statement Audit

Source: SAS No. 122; SAS No. 128; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 143; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, are to be applied regarding risks of material misstatement due to fraud.

Characteristics of Fraud

.02 Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

.03 Although fraud is a broad legal concept, for the purposes of generally accepted auditing standards (GAAS), the auditor is primarily concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor — misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (Ref: par. .A1–.A8)

Responsibility for the Prevention and Detection of Fraud

.04 The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, places a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior, which can be reinforced by active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of financial statement users regarding the entity's performance and profitability.

Responsibilities of the Auditor

.05 An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Due to the inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS.[1]

.06 As described in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud.[2] The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. Although the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas, such as accounting estimates, are caused by fraud or error.

.07 Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override controls designed to prevent similar frauds by other employees. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.08 When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls, and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this section are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

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[1]Paragraphs .A55–.A56 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .A55 of section 200.

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.10

The objectives of the auditor are to

a. identify and assess the risks of material misstatement of the financial statements due to fraud;

b. obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

c. respond appropriately to fraud or suspected fraud identified during the audit.

Definitions

.11 For purposes of GAAS, the following terms have the meanings attributed as follows:

Fraud. An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

Fraud risk factors. Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action. (Ref: par. .A11, .A30, and .A57)

Significant unusual transactions. Significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Requirements

Professional Skepticism

.12 In accordance with section 200, the auditor should maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.[3] (Ref: par. .A9–.A10)

.13 Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor should investigate further. (Ref: par. .A11)

.14 When responses to inquiries of management, those charged with governance, or others are inconsistent or otherwise unsatisfactory (for example, vague or implausible), the auditor should further investigate the inconsistencies or unsatisfactory responses.

Discussion Among the Engagement Team

.15 Section 315A requires a discussion among the key engagement team members, including the engagement partner, and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.[4] This discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity's financial statements (including the individual statements and the disclosures) might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address (Ref: par. .A12–.A13)

a. known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud;

b. the risk of management override of controls;

c. consideration of circumstances that might be indicative of earnings management or manipulation of other financial measures and the practices that might be followed by management to manage earnings or other financial measures that could lead to fraudulent financial reporting;

d. the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement due to fraud; and

e. how the auditor might respond to the susceptibility of the entity's financial statements to material misstatement due to fraud.

Communication among the engagement team members about the risks of material misstatement due to fraud should continue throughout the audit, particularly upon discovery of new facts during the audit. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[3]Paragraph .17 of section 200.

[4]Paragraph .11 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Risk Assessment Procedures and Related Activities

.16 When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, required by SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the auditor should perform the procedures in paragraphs .17–.24 to obtain information for use in identifying the risks of material misstatement due to fraud.[5] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Discussions With Management and Others Within the Entity

.17 The auditor should make inquiries of management regarding

a. management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent, and frequency of such assessments; (Ref: par. .A14–.A15)

b. management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: par. .A16)

c. management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;

d. management's communication, if any, to employees regarding its views on business practices and ethical behavior; and

e. whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.18 The auditor should make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity. (Ref: par. .A17–.A20)

.19 For those entities that have an internal audit function,[6] the auditor should make inquiries of appropriate individuals within the internal audit function to obtain their views about the risks of fraud; determine whether they have knowledge of any actual, suspected,

[5] Paragraphs .05–.25 of section 315A.

[6] Section 610, *Using the Work of Internal Auditors*, provides guidance in audits of those entities that have an internal audit function. [Footnote amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

or alleged fraud affecting the entity; whether they have performed any procedures to identify or detect fraud during the year; whether management has satisfactorily responded to any findings resulting from these procedures; and whether they are aware that the entity has entered into any significant unusual transactions. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Those Charged With Governance

.20 Unless all of those charged with governance are involved in managing the entity,[7] the auditor should obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to mitigate these risks. (Ref: par. .A21–.A23) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.21 Unless all of those charged with governance are involved in managing the entity, the auditor should make inquiries of those charged with governance (or the audit committee or, at least, its chair) to determine their views about the risks of fraud, whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity, and whether the entity has entered into any significant unusual transactions. These inquiries are made, in part, to corroborate the responses received from the inquiries of management. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Unusual or Unexpected Relationships Identified

.22 Based on analytical procedures performed as part of risk assessment procedures,[8] the auditor should evaluate whether unusual or unexpected relationships that have been identified indicate risks of material misstatement due to fraud. To the extent not already included, the analytical procedures, and evaluation thereof, should include procedures relating to revenue accounts. (Ref: par. .A24–.A26 and .A46)

Other Information

.23 The auditor should consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: par. .A27)

Evaluation of Fraud Risk Factors

.24 The auditor should evaluate whether the information obtained from the risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. Although fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances in which frauds have occurred and, therefore, may indicate risks of material misstatement due to fraud. (Ref: par. .A28–.A32)

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[7]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[8]Paragraphs .06(*b*) and .A7–.A10 of section 315A.

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

.25 In accordance with section 315A, the auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances, and disclosures.[9] The auditor's risk assessment should be ongoing throughout the audit, following the initial assessment.

.26 When identifying and assessing the risks of material misstatement due to fraud, the auditor should, based on a presumption that risks of fraud exist in revenue recognition, evaluate which types of revenue, revenue transactions, or assertions give rise to such risks. Paragraph .46 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: par. .A33–.A35)

.27 The auditor should treat those assessed risks of material misstatement due to fraud as significant risks and, accordingly, to the extent not already done so, the auditor should identify the entity's controls that address such risks and evaluate their design and determine whether they have been implemented.[10] (Ref: par. .A36–.A37) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

.28 In accordance with section 330, the auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.[11] (Ref: par. .A38)

.29 In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor should

a. assign and supervise personnel, taking into account the knowledge, skill, and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: par. .A39–.A40)

b. evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort

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[9]Paragraph .26 of section 315A.

[10]Paragraphs 26*a*(i) and *d* of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[11]Paragraph .05 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

to manage earnings, or a bias that may create a material misstatement; and (Ref: par. .A41)

c. incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures. (Ref: par. .A42)

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

.30 In accordance with section 330, the auditor should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.[12] (Ref: par. .A43–.A46)

Audit Procedures Responsive to Risks Related to Management Override of Controls

.31 Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is, nevertheless, present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and, thus, a significant risk.

.32 Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to

a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to financial statement drafts. In designing and performing audit procedures for such tests, the auditor should (Ref: par. .A47–.A50 and .A56)

   i. obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, and, in accordance with SAS No. 145, evaluate the design and determine whether the controls have been implemented;[13]

   ii. make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;

   iii. consider fraud risk indicators, the nature and complexity of accounts, and unusual entries processed;

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[12]Paragraph .06 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[13]Paragraph 26*a* and *c* of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

  iv. select journal entries and other adjustments made at the end of a reporting period; and

  v. consider the need to test journal entries and other adjustments throughout the period.

b. review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor should

  i. evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor should reevaluate the accounting estimates taken as a whole, and

  ii. perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. Estimates selected for review should include those that are based on highly sensitive assumptions or are otherwise significantly affected by judgments made by management. (Ref: par. .A51–.A53)

c. evaluate, given the auditor's understanding of the entity and its environment and other information obtained during the audit, whether the business purpose (or the lack thereof) of significant unusual transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The procedures should include the following: (Ref: par. .A54–.A55)

  i. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction

  ii. Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures

  iii. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Other Audit Procedures

.33 The auditor should determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to previously (that is, when specific additional risks of management override exist that are not covered as part of the procedures performed to address the requirements in paragraph .32). (Ref: par. .A56)

Evaluation of Audit Evidence (Ref: par. .A57)

.34 The auditor should evaluate, at or near the end of the audit, whether the accumulated results of auditing procedures (including analytical procedures that were performed as substantive tests or when forming an overall conclusion) 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. If not already performed when forming an overall conclusion, the analytical procedures relating to revenue, required by paragraph .22, should be performed through the end of the reporting period. (Ref: par. .A58–.A59)

.35 If the auditor identifies a misstatement, the auditor should evaluate whether such a misstatement is indicative of 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. (Ref: par. .A60–.A63)

.36 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. 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. (Ref: par. .A61)

.37 If the auditor concludes that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor should evaluate the implications for the audit. (Ref: par. .A62)

Auditor Unable to Continue the Engagement

.38 If, as a result of identified fraud or suspected fraud, the auditor encounters circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should

a. determine the professional and legal responsibilities applicable in the circumstances, including whether a requirement exists for the auditor to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities;

b. consider whether it is appropriate to withdraw from the engagement, when withdrawal is possible under applicable law or regulation; and

c. if the auditor withdraws

   i. discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal, and

   ii. determine whether a professional or legal requirement exists to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. (Ref: par. .A64–.A67)

Communications to Management and With Those Charged With Governance

.39 If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. .A68)

.40 Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving

a. management,

b. employees who have significant roles in internal control, or

c. others, when the fraud results in a material misstatement in the financial statements,

the auditor should communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor should communicate these suspicions to those charged with governance and discuss with them the nature, timing, and extent of audit procedures necessary to complete the audit. (Ref: par. .A69–.A71)

.41 The auditor should communicate with those charged with governance any other matters related to fraud that are, in the auditor's professional judgment, relevant to their responsibilities. (Ref: par. .A72)

Communications to Regulatory and Enforcement Authorities

.42 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. (Ref: par. .A73–.A75)

Documentation

.43 The auditor should include in the audit documentation[14] the identification and the assessment of the risks of material misstatement required by SAS No. 145, which includes the following:[15]

a. The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, and how and when the discussion occurred and the audit team members who participated

b. The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level (See paragraphs .16–.27.)

c. Identified controls in the control activities component that address assessed risks of material misstatement due to fraud

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.44 The auditor should include in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by section 330 the following:[16]

a. The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing, and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level

b. The results of the audit procedures, including those designed to address the risk of management override of controls

.45 The auditor should include in the audit documentation communications about fraud made to management, those charged with governance, regulators, and others.

.46 If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is overcome in the circumstances of the engagement, the auditor should include in the audit documentation the reasons for that conclusion.

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[14] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[15] Paragraph .33 of section 315A. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[16] Paragraph .30 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Application and Other Explanatory Material

Characteristics of Fraud (Ref: par. .03)

.A1 Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so, and some rationalization of the act, as follows:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps, unrealistic) earnings target or financial outcome — particularly because the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets (for example, because the individuals are living beyond their means).
- A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden (for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control).
- Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character, or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

.A2 Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions about the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

.A3 An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Accordingly, the auditor is primarily concerned with fraud that causes a material misstatement of the financial statements. However, in conducting the audit, the auditor may identify misstatements arising from fraud that are not material to the financial statements. Paragraphs .35–.36 and .39–.42 address the auditor's responsibilities in such circumstances in evaluating audit evidence and in communicating audit findings, respectively.

.A4 Intent is often difficult to determine, particularly in matters involving accounting estimates and the application of accounting principles. For example, unreasonable accounting estimates may be unintentional or may be the result of an intentional attempt to misstate the financial statements. Although an audit is not designed to determine intent, the auditor's objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.[17]

.A5 Fraudulent financial reporting may be accomplished by the following:

- Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information
- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure

.A6 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls intentionally using such techniques as the following:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- Omitting, obscuring, or misstating disclosures required by the applicable financial reporting framework or disclosures that are necessary to achieve fair presentation
- Concealing facts that could affect the amounts recorded in the financial statements
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to significant and unusual transactions

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A7 Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management, who is usually better able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including the following:

[17] Paragraph .12 of section 200. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts from written-off accounts to personal bank accounts)
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, or colluding with a competitor by disclosing technological data in return for payment)
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for approving payment at inflated prices, or payments to fictitious employees)
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party)

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A8 The auditor of governmental entities and not-for-profit organizations may have additional responsibilities relating to fraud

- as a result of being engaged to conduct an audit in accordance with law or regulation applicable to governmental entities and not-for-profit organizations,
- because of a governmental audit organization's mandate, or
- because of the need to comply with *Government Auditing Standards*.

Consequently, the responsibilities of the auditor of governmental entities and not-for-profit organizations may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.

Professional Skepticism (Ref: par. .12–.14)

.A9 Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and identified controls in the control activities, if any, over its preparation and maintenance. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A10 Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.

.A11 An audit performed in accordance with GAAS rarely involves the authentication of documents, nor is the auditor trained as, or expected to be, an expert in such authentication.[18] However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic, that terms in a document have been modified but not disclosed to the auditor, or that undisclosed side agreements may exist, possible procedures to investigate further may include

- confirming directly with the third party.
- using the work of a specialist to assess the document's authenticity.

Appendix C, "Examples of Circumstances That Indicate the Possibility of Fraud," contains examples of circumstances that may indicate the possibility of fraud.

Discussion Among the Engagement Team (Ref: par. .15)

.A12 Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team

- provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
- enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention during the audit.

.A13 The discussion may lead to a thorough probing of the issues, acquiring of additional evidence as necessary, and consulting with other team members and, if appropriate, specialists in or outside the firm. The discussion may include the following matters:

- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by using unclear or ambiguous language)
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud

[18] Paragraph .A51 of section 200. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor's attention

A number of factors may influence the extent of the discussion and how it may occur. For example, if the audit involves more than one location, there could be multiple discussions with team members in differing locations. Another factor in planning the discussions is whether to include specialists assigned to the audit team. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Risk Assessment Procedures and Related Activities

Inquiries of Management

Management's Assessment of the Risk of Material Misstatement Due to Fraud (Ref: par. .17a)

.A14 Management accepts responsibility for the entity's internal control and for the preparation and fair presentation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent, and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent, and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may, in some circumstances, be indicative of the lack of importance that management places on internal control.

.A15 *Considerations specific to smaller, less complex entities.* In some entities, particularly smaller entities, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.

Management's Process for Identifying and Responding to the Risks of Fraud (Ref: par. .17b)

.A16 In the case of entities with multiple locations, management's processes may include different levels of monitoring of operating locations or business segments. Management may also have identified particular operating locations or business segments for which a risk of fraud may be more likely to exist.

Discussions With Management and Others Within the Entity (Ref: par. .17–.19)

.A17 Inquiries of management and others within the entity are generally most effective when they involve an in-person discussion. The auditor may also determine it useful to provide the interviewee with specific questions and obtain written responses in advance of the discussion.

.A18 The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity, in addition to management, may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated. It may be useful in providing the auditor with a perspective that is different from that of individuals in the financial reporting process. The responses to these other inquiries might serve to corroborate responses received from management or, alternatively, might provide information regarding the possibility of management override of controls. The auditor may also obtain information about how effectively management has communicated standards of ethical behavior throughout the organization.

.A19 Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include the following:

- Operating personnel not directly involved in the financial reporting process
- Employees with different levels of authority
- Employees involved in initiating, processing, or recording complex or unusual transactions (for example, a sales transaction with multiple elements or a significant related party transaction) and those who supervise or monitor such employees
- In-house legal counsel
- Chief ethics officer or equivalent person
- The person or persons charged with dealing with allegations of fraud

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A20 Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.

Obtaining an Understanding of Oversight Exercised by Those Charged With Governance (Ref: par. .20)

.A21 Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control, and compliance with the law. In some circumstances, governance practices are well developed, and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and the controls that address such risks. Because the responsibilities of those charged with governance and management may vary by entity, it is important that the auditor understands the respective responsibilities of those charged with governance and management to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.[19] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of controls that address risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings during which such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Considerations Specific to Smaller, Less Complex Entities

.A23 In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a small entity in which a single owner manages the entity, and no one else has a governance role. In these cases, ordinarily, no action exists on the part of the auditor because no oversight exists separate from management.

Unusual or Unexpected Relationships Identified (Ref: par. .22)

.A24 Analytical procedures may include data analysis techniques ranging from a high-level review of data patterns, relationships, and trends to highly sophisticated, computer-assisted investigation of detailed transactions using electronic tools, such as data mining, business intelligence, and file query tools. The degree of reliance that can be placed on such techniques is a function primarily of the source (for example, financial, nonfinancial), completeness and reliability of the data, the level of disaggregation, and the nature of the analysis.

.A25 Analytical procedures relating to revenue that are performed with the objective of identifying unusual or unexpected relationships that may indicate a material misstatement due to fraudulent financial reporting may include

a. a comparison of sales volume, as determined from recorded revenue amounts, with production capacity. An excess of sales volume over production capacity may be indicative of recording fictitious sales.

b. a trend analysis of revenues by month and sales returns by month, during and shortly after the reporting period. This may indicate the existence of undisclosed side agreements with customers involving the return of goods, which, if known, would preclude revenue recognition.

c. a trend analysis of sales by month compared with units shipped. This may identify a material misstatement of recorded revenues.

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[19]Paragraphs .A6–.A12 of section 260 discuss with whom the auditor communicates when the entity's governance structure is not well defined. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A26 Analytical procedures performed during planning may be helpful in identifying the risks of material misstatement due to fraud. However, if such analytical procedures use data aggregated at a high level, generally the results of those analytical procedures provide only a broad initial indication about whether a material misstatement of the financial statements may exist. Accordingly, the results of analytical procedures performed during planning may be considered along with other information gathered by the auditor in identifying the risks of material misstatement due to fraud.

Other Information (Ref: par. .23)

.A27 In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Evaluation of Fraud Risk Factors (Ref: par. .24)

.A28 The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors), such as the following:

- The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud.
- The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud.
- A control environment that is not effective may create an opportunity to commit fraud.

.A29 Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities in which the specific conditions do not present risks of material misstatement. Accordingly, the determination of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the financial statements due to fraud requires the exercise of professional judgment.

.A30 Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in appendix A, "Examples of Fraud Risk Factors." These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud
- A perceived opportunity to commit fraud
- An ability to rationalize the fraudulent action

The inability to observe one or more of these conditions does not necessarily mean that no risk of material misstatement due to fraud exists.

Fraud risk factors may relate to incentives, pressures, or opportunities that arise from conditions that create susceptibility to misstatement before consideration of controls. Fraud risk factors, which include intentional management bias, are inherent risk factors insofar as they affect inherent risk. Fraud risk factors may also relate to conditions within the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalize fraudulent actions. Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.[20] Although the fraud risk factors described in appendix A cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A31 The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as

- effective oversight by those charged with governance.
- an effective internal audit function.
- the existence and enforcement of a written code of conduct.

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level.

Considerations Specific to Smaller, Less Complex Entities

.A32 In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude

[20]Paragraph 21 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control because an opportunity exists for management override of controls.

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

Risks of Fraud in Revenue Recognition (Ref: par. .26)

.A33 Material misstatement due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may result also from an understatement of revenues through, for example, improperly shifting revenues to a later period.

.A34 The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales.

.A35 The presumption that risks of fraud exist in revenue recognition may be rebutted. For example, the auditor may conclude that no risk of material misstatement due to fraud relating to revenue recognition exists in the case in which a single type of simple revenue transaction exists, for example, leasehold revenue from a single unit rental property.

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: par. .27)

.A36 Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.[21] In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.

.A37 It is, therefore, important for the auditor to obtain an understanding of the controls that management has designed, implemented, and maintained to prevent and detect fraud. In identifying the controls that address the risks of material misstatement due to fraud, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from identifying these controls and evaluating their design and determining whether they have been implemented

[21] Paragraph .A49 of section 315A. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: par. .28)

.A38 Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism through, for example, increased

- sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- recognition of the need to corroborate management explanations or representations concerning material matters.

Determining overall responses to address the assessed risks of material misstatement due to fraud also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph .29, which are discussed in the following sections.

Assignment and Supervision of Personnel (Ref: par. .29a)

.A39 The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT specialists, or by assigning more experienced individuals to the engagement.

.A40 The extent of supervision reflects the auditor's assessment of risks of material misstatement due to fraud and the competencies of the engagement team members performing the work.

Accounting Principles (Ref: par. .29b)

.A41 Management bias in the selection and application of accounting principles may individually or collectively involve matters such as contingencies, fair value measurements, revenue recognition, accounting estimates, related party transactions, or other transactions without a clear business purpose.

Unpredictability in the Selection of Audit Procedures (Ref: par. .29c)

.A42 Incorporating an element of unpredictability in the selection of the nature, timing, and extent of audit procedures to be performed is important because individuals within the entity who are familiar with the audit procedures normally performed on engagements may be better able to conceal fraudulent financial reporting. This can be achieved by, for example,

- performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.
- adjusting the timing of audit procedures from that otherwise expected.
- using different sampling methods.
- performing audit procedures at different locations or at locations on an unannounced basis.

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (Ref: par. .30)

.A43 The auditor's responses to address the assessed risks of material misstatement due to fraud at the assertion level may include changing the nature, timing, and extent of audit procedures in the following ways:

- The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example:
  - — Physical observation or inspection of certain assets may become more important, or the auditor may choose to use computer-assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files.
  - — The auditor may design procedures to obtain additional corroborative information. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms.
- The timing of substantive procedures may need to be modified. The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement — for example, a misstatement involving improper revenue recognition — may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period.
- The extent of the procedures applied reflects the assessment of the risks of material misstatement due to fraud. For example, increasing sample sizes or performing

analytical procedures at a more detailed level may be appropriate. Also, computer-assisted audit techniques may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

.A44 If the auditor identifies a risk of material misstatement due to fraud that affects inventory quantities, examining the entity's inventory records may help to identify locations or items that require specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis or to conduct inventory counts at all locations on the same date.

.A45 The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions. These may include asset valuation, estimates relating to specific transactions (such as acquisitions, restructurings, or disposals of segments of the business), and other significant accrued liabilities (such as pension and other postemployment benefit obligations, or environmental remediation liabilities). The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.

.A46 Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud, including those that illustrate the incorporation of an element of unpredictability, are presented in appendix B, "Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud." The appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: par. .32a)

.A47 Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (*a*) recording inappropriate or unauthorized journal entries throughout the year or at period end, or (*b*) making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidating adjustments, report combinations, and reclassifications.

.A48 The auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries[22] is important because automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, when IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

.A49 When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters may be relevant:

- *The identification and assessment of the risks of material misstatement due to fraud.* The presence of fraud risk factors and other information obtained during the auditor's identification and assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.
- *Controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.
- *The entity's financial reporting process and the nature of evidence that can be obtained.* For many entities, routine processing of transactions involves a combination of manual and automated procedures and controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated procedures and controls. When IT is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.
- *The characteristics of fraudulent journal entries or other adjustments.* Inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (*a*) made to unrelated, unusual, or seldom-used accounts; (*b*) made by individuals who typically do not make journal entries; (*c*) recorded at the end of the period or as postclosing entries that have little or no explanation or description; (*d*) made either before or during the preparation of the financial statements that do not have account numbers; or (*e*) containing round numbers or consistent ending numbers.
- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (*a*) contain transactions that are complex or unusual in nature, (*b*) contain significant estimates and period-end adjustments, (*c*) have been prone to misstatements in the past, (*d*) have not been reconciled on a timely basis or contain unreconciled differences, (*e*) contain intercompany transactions, or (*f*) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.
- *Journal entries or other adjustments processed outside the normal course of business.* Nonstandard journal entries, and other entries such as consolidating adjustments, may not be subject to the same nature and extent of controls as those journal entries

[22] Paragraph 27*b* of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A50 The auditor exercises professional judgment in determining the nature, timing, and extent of testing of journal entries and other adjustments. However, because fraudulent journal entries and other adjustments are often made at the end of a reporting period, paragraph .32*a*(iv) requires the auditor to select the journal entries and other adjustments made at that time. Further, because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, paragraph .32*a*(v) requires the auditor to consider whether a need also exists to test journal entries and other adjustments throughout the period.

Accounting Estimates (Ref: par. .32b)

.A51 The preparation and fair presentation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions about the entity's performance and profitability.

.A52 The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether an indication exists of a possible bias on the part of management. This review is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.

.A53 A retrospective review is also required by section 540, *Auditing Accounting Estimates and Related Disclosures*.[23] That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's previous accounting estimates, audit evidence about the outcome, or when applicable, the subsequent reestimation to assist in identifying and assessing the risks of material misstatement in the current period, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this section may be carried out in conjunction with the review required by section 540. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

[23]Paragraph .13 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143. Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Business Purpose for Significant Unusual Transactions (Ref: par. .32c)

.A54 Indicators that may suggest that significant unusual transactions may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include the following:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and inadequate documentation exists.
- Management is placing more emphasis on the need for a particular accounting treatment than on the economic substance of the transaction.
- Transactions involve nonconsolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- Transactions involve related parties or relationships or transactions with related parties previously undisclosed to the auditor.
- Transactions involve other parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit or any related party of the entity.
- Transactions lack commercial or economic substance or are part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (for example, a transaction is entered into shortly prior to period end and is unwound shortly after period end).
- Transactions occur with a party that falls outside the definition of a related party (as defined by the applicable financial reporting framework), with either party able to negotiate terms that may not be available for other, more clearly independent parties on an arm's-length basis.
- Transactions exist to enable the entity to achieve certain financial targets.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A55 Procedures for evaluating significant unusual transactions may include evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees and other obligations, if any. Examples of information that might be relevant to the auditor's evaluation of a related party's financial capability include, among other things, the audited financial statements of the related party, reports issued by regulatory agencies, financial publications, and income tax returns of the related party, to the extent available. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Other Audit Procedures (Ref: par. .32a and .33)

.A56 Risks of material misstatement, including misstatements due to fraud, cannot be reduced to an appropriately low level by performing only tests of controls.[24] [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of Audit Evidence (Ref: par. .34–.37)

.A57 Section 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.[25] This evaluation is primarily a qualitative matter based on the auditor's professional judgment. Such an evaluation may provide further insight into the risks of material misstatement due to fraud and whether a need exists to perform additional or different audit procedures. Appendix C contains examples of circumstances that may indicate the possibility of fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: par. .34)

.A58 Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These might include, for example, uncharacteristically large amounts of income being reported in the last few weeks of the reporting period or unusual transactions or income that is inconsistent with trends in cash flow from operations. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A59 Some unusual or unexpected analytical relationships may have been identified and may indicate a risk of material misstatement due to fraud because management or employees generally are unable to manipulate certain information to create seemingly normal or expected relationships. Some examples are as follows:

- The relationship of net income to cash flows from operations may appear unusual because management recorded fictitious revenues and receivables but was unable to manipulate cash.
- Changes in inventory, accounts payable, sales, or cost of sales from the prior period to the current period may be inconsistent, indicating a possible employee theft of inventory, because the employee was unable to manipulate all of the related accounts.
- A comparison of the entity's profitability to industry trends, which management cannot manipulate, may indicate trends or differences for further consideration when identifying risks of material misstatement due to fraud.

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[24] Paragraph .A9 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[25] Paragraph .27 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- A comparison of bad debt write-offs to comparable industry data, which employees cannot manipulate, may provide unexplained relationships that could indicate a possible theft of cash receipts.
- An unexpected or unexplained relationship between sales volume, as determined from the accounting records and production statistics maintained by operations personnel, which may be more difficult for management to manipulate, may indicate a possible misstatement of sales.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Consideration of Identified Misstatements (Ref: par. .35–.37)

.A60 Because fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so, or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements at a specific location even though the cumulative effect is not material, may be indicative of a risk of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A61 The implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question because there may be doubts about the completeness and truthfulness of representations made and the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management, or third parties. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A62 Section 450, *Evaluation of Misstatements Identified During the Audit*, and section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the evaluation and disposition of misstatements and the effect on the auditor's opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A63 Section 580, *Written Representations*, addresses obtaining appropriate representations from management in the audit. In addition to acknowledging its responsibility for the financial statements, it is important that, irrespective of the size of the entity, management acknowledges its responsibility for internal control designed, implemented, and maintained to prevent and detect fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Auditor Unable to Continue the Engagement (Ref: par. .38)

.A64 Examples of circumstances that may arise and bring into question the auditor's ability to continue performing the audit include the following:

a. The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances, even when the fraud is not material to the financial statements.

b. The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud.

c. The auditor has significant concern about the competence or integrity of management or those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A65 Because of the variety of circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor's conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A66 The auditor has professional and legal responsibilities in such circumstances, and these responsibilities may vary by engagement. In some circumstances, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities. Given the nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to regulators or others.[26] [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A67 For governmental entities and not-for-profit organizations, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate, public interest considerations, contractual requirements, or law or regulation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Communications to Management and With Those Charged With Governance

Communication to Management (Ref: par. .39)

.A68 When the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is true even if the matter might be considered inconsequential (for example, a minor defalcation by an employee at a low level in the entity's organization).

[26]Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, provides guidance on communications with an auditor replacing the existing auditor. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the suspected fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Communication With Those Charged With Governance (Ref: par. .40)

.A69 The auditor's communication with those charged with governance may be made orally or in writing. Section 260, *The Auditor's Communication With Those Charged With Governance*, identifies factors the auditor considers in determining whether to communicate orally or in writing.[27] Due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements, the auditor communicates such matters on a timely basis and may consider it necessary to also communicate such matters in writing. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A70 In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A71 When the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Other Matters Related to Fraud (Ref: par. .41)

.A72 Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example, the following:

- Concerns about the nature, extent, and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to appropriately address identified significant deficiencies or material weaknesses in internal control, or to appropriately respond to an identified fraud.
- The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be

[27] Paragraph .A49 of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions concerning the entity's performance and profitability.

- Concerns about the adequacy and completeness of the authorization of significant unusual transactions.
- The absence of programs or controls to address risks of material misstatement due to fraud that are significant deficiencies or material weaknesses.[28]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Communications to Regulatory and Enforcement Authorities (Ref: par. .42)

.A73 The auditor's professional duty to maintain the confidentiality of client information may preclude reporting fraud to a party outside the client entity. However, in certain circumstances, the duty of confidentiality may be overridden by statute, regulation, courts of law, specific requirements of audits of entities that receive government financial assistance, or waived by agreement. In some circumstances, the auditor has a statutory duty to report the occurrence of fraud to supervisory authorities. Also, in some circumstances, the auditor has a duty to report misstatements to authorities in those cases when management and those charged with governance fail to take corrective action. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A74 The auditor may consider it appropriate to obtain legal advice to determine the appropriate course of action in the circumstances, the purpose of which is to ascertain the steps necessary in considering the public interest aspects of identified fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A75 For governmental entities and not-for-profit organizations, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law or regulation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

[28] See section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Appendix A — Examples of Fraud Risk Factors (Ref: par. .11, .24, and .A30)

.A76

The fraud risk factors identified in this appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration — that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (*a*) incentives and pressures, (*b*) opportunities, and (*c*) attitudes and rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities that arise from conditions that create susceptibility to misstatement before consideration of controls (that is, the determination is based on inherent risk). Such factors are inherent risk factors and may be due to susceptibility to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (for example, complexity or uncertainty may create opportunities that result in susceptibility to misstate-ment due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or control deficiencies in the entity's control environment.

Risk Factors Relating to Misstatements Arising From Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives and Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by) the following:

- High degree of competition or market saturation, accompanied by declining margins
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates
- Significant declines in customer demand and increasing business failures in either the industry or overall economy

- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry
- New accounting, statutory, or regulatory requirements

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages
- Need to obtain additional debt or equity financing to stay competitive — including financing of major research and development or capital expenditures
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards
- A need to achieve financial targets required in bond covenants
- Pressure for management to meet the expectations of legislative or oversight bodies or to achieve political outcomes, or both

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow[1]
- Personal guarantees of debts of the entity

Management or operating personnel are under excessive pressure to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

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[1]Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Related party transactions that are also significant unusual transactions
- Significant transactions with related parties whose financial statements are not audited or are audited by another firm
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate
- Significant or highly complex transactions or significant unusual transactions, especially those close to period end that pose difficult "substance over form" questions
- Significant operations located or conducted across jurisdictional borders where differing business environments and regulations exist
- Use of business intermediaries for which there appears to be no clear business justification
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification
- Contractual arrangements lacking a business purpose

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.
- The exertion of dominant influence by or over a related party.

The organizational structure is complex or unstable, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority
- High turnover of senior management, legal counsel, or those charged with governance

Deficiencies in internal control are a result of the following:

- Inadequate process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (when external reporting is required)
- High turnover rates or employment of staff in accounting, IT, or the internal audit function who are not effective
- Accounting and information systems that are not effective, including situations involving significant deficiencies or material weaknesses in internal control
- Weak controls over budget preparation and development and compliance with law or regulation.

Attitudes and Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities law or other law or regulation, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of law or regulation.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies or material weaknesses in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- A strained relationship between management and the current or predecessor auditor, as exhibited by the following:
  - — Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters

— Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report

— Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance

— Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement

Risk Factors Arising From Misstatements Arising From Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives and pressures, opportunities, and attitudes and rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control that are not effective may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives and Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs
- Recent or anticipated changes to employee compensation or benefit plans
- Promotions, compensation, or other rewards inconsistent with expectations

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when the following exist:

- Large amounts of cash on hand or processed
- Inventory items that are small in size, of high value, or in high demand

- Easily convertible assets, such as bearer bonds, diamonds, or computer chips
- Fixed assets that are small in size, marketable, or lack observable identification of ownership

Inadequate controls over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because the following exist:

- Inadequate segregation of duties or independent checks
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements
- Inadequate management oversight of employees responsible for assets (for example, inadequate supervision or monitoring of remote locations)
- Inadequate job applicant screening of employees with access to assets
- Inadequate record keeping with respect to assets
- Inadequate system of authorization and approval of transactions (for example, in purchasing)
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets
- Lack of complete and timely reconciliations of assets
- Lack of timely and appropriate documentation of transactions (for example, credits for merchandise returns)
- Lack of mandatory vacations for employees performing key control functions
- Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation
- Inadequate access controls over automated records, including controls over and review of computer systems event logs

Attitudes and Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets
- Disregard for controls over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee
- Changes in behavior or lifestyle that may indicate assets have been misappropriated

- The belief by some government or other officials that their level of authority justifies a certain level of compensation and personal privileges
- Tolerance of petty theft

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Appendix B — Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud (Ref: par. .22 and .A46)

.A77

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly, they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures, and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis (for example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis)
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period
- Altering the audit approach in the current year (for example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information)
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear to have an unusual nature or amount
- For significant and unusual transactions, particularly those occurring at or near year end, investigating the possibility of related parties and the sources of financial resources supporting the transactions
- Performing substantive analytical procedures using disaggregated data (for example, comparing sales and cost of sales by location, line of business, or month to expectations developed by the auditor)
- Conducting interviews of personnel involved in areas in which a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk, and whether, or how, controls address the risk

- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions, or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components
- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods, or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods
- Performing computer-assisted techniques, such as data mining to test for anomalies in a population
- Testing the integrity of computer-produced records and transactions
- Seeking additional audit evidence from sources outside of the entity being audited

Specific Responses — Misstatement Resulting From Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data; for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods or with revenue related to cash collections (computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions)
- Confirming with customers certain relevant contract terms and the absence of side agreements because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented (for example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances)

- Inquiring of the entity’s sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period
- Performing additional procedures during the observation of the count; for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals (using the work of an expert may be helpful in this regard)
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records
- Using computer-assisted audit techniques to further test the compilation of the physical inventory counts (for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication)

Management Estimates

- Using an expert to develop an independent estimate for comparison to management’s estimate
- Extending inquiries to individuals outside of management and the accounting department to corroborate management’s ability and intent to carry out plans that are relevant to developing the estimate

Specific Responses — Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the preceding two categories may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year end
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit
- Analyzing recoveries of written-off accounts
- Analyzing inventory shortages by location or product type
- Comparing key inventory ratios to industry norm
- Reviewing supporting documentation for reductions to the perpetual inventory records
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers, or bank accounts
- Reviewing personnel files for those that contain little or no evidence of activity; for example, lack of performance evaluations
- Analyzing sales discounts and returns for unusual patterns or trends
- Confirming specific terms of contracts with third parties
- Obtaining evidence that contracts are being carried out in accordance with their terms
- Reviewing the propriety of large and unusual expenses
- Reviewing the authorization and carrying value of senior management and related party loans
- Reviewing the level and propriety of expense reports submitted by senior management

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Appendix C — Examples of Circumstances That Indicate the Possibility of Fraud (Ref: par. .11, .A11, and .A57)

.A78

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

Discrepancies in the accounting records, including the following:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded by amount, accounting period, classification, or entity policy
- Unsupported or unauthorized balances or transactions
- Last minute adjustments that significantly affect financial results
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties
- Tips or complaints to the auditor about alleged fraud

Conflicting or missing evidence, including the following:

- Missing documents
- Documents that appear to have been altered
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist
- Significant unexplained items on reconciliations
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships; for example, receivables growing faster than revenues
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures
- Unusual discrepancies between the entity's records and confirmation replies
- Large numbers of credit entries and other adjustments made to accounts receivable records
- Unexplained or inadequately explained differences between the accounts receivable subledger and the control account, or between the customer statements and the accounts receivable subledger
- Missing or nonexistent cancelled checks in circumstances in which cancelled checks are ordinarily returned to the entity with the bank statement
- Missing inventory or physical assets of significant magnitude

- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments

Conditions relating to governmental entities or not-for-profit organizations:

- Significant transfers or transactions between funds or programs, or both, lacking supporting documents
- Abnormal budget conditions, such as
  — significant budget adjustments
  — requests for additional funding
  — budget adjustments made without approval
  — large amounts of over-or-under spending
  — programs with an emphasis on spending money quickly
- Procurement conditions, such as
  — lack of procurement legislation
  — recent changes to procurement legislation
  — complex or unclear legislation
  — involvement of significant monetary amounts (such as in the defense area)
  — investigation by regulatory authorities
  — complaints received from potential suppliers about questionable practices related to awarding of contracts
  — former governmental officials functioning as executives of companies to which contracts have been awarded
- Program conditions, such as
  — newly implemented programs without existing management and accountability structures
  — programs established for political purposes
  — programs established to deal with an immediate emergency or crisis
  — programs experiencing unusual growth due to conditions beyond the control of management

- Grant and donor funding conditions, such as
  - — noncompliance with grant requirements
  - — unclear grant requirements
  - — grants not reaching the intended recipient
  - — complaints from intended recipients or interest groups, and lack of monitoring of grantee compliance with applicable law or regulation

Problematic or unusual relationships between the auditor and management, including the following:

- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought
- Undue time pressures imposed by management to resolve complex or contentious issues
- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management
- Unusual delays by the entity in providing requested information
- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable
- An unwillingness to address identified deficiencies in internal control on a timely basis

Other circumstances, including the following:

- Unwillingness by management to permit the auditor to meet privately with those charged with governance
- Accounting policies that appear to be at variance with industry norms
- Frequent changes in accounting estimates that do not appear to result from changed circumstances
- Tolerance of violations of the entity's code of conduct

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

AU-C Section 250

Consideration of Laws and Regulations in an Audit of Financial Statements

Source: SAS No. 122; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to consider laws and regulations in an audit of financial statements. This section does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.[1]

Effect of Laws and Regulations

.02 The effect on financial statements of laws and regulations varies considerably. Those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity's financial statements. Other laws or regulations are to be complied with by management, or set the provisions under which the entity is allowed to conduct its business, but do not have a direct effect on an entity's financial statements. Some entities operate in heavily regulated industries (such as banks and chemical companies). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to occupational safety and health and equal employment opportunity). Noncompliance with laws and regulations may result in fines, litigation, or other consequences for the entity that may have a material effect on the financial statements.

[1]Section 935, *Compliance Audits*, addresses compliance audits performed in accordance with generally accepted auditing standards, the standards for financial audits under *Government Auditing Standards*, and government audit requirements.

Responsibility for Compliance With Laws and Regulations (Ref: par. .A1–.A7)

Responsibility of Management

.03 It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

Responsibility of the Auditor

.04 The requirements in this section are designed to assist the auditor in identifying material misstatement of the financial statements due to noncompliance with laws and regulations. However, the auditor is not responsible for preventing noncompliance and cannot be expected to detect noncompliance with all laws and regulations.

.05 The auditor is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.[2] In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Because of the inherent limitations of an audit, an unavoidable risk exists that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with generally accepted auditing standards (GAAS).[3] In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for the following reasons:

- Many laws and regulations relating principally to the operating aspects of an entity typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.
- Noncompliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls, or intentional misrepresentations made to the auditor.
- Whether an act constitutes noncompliance is ultimately a matter for legal determination, such as by a court of law.

Ordinarily, the further removed noncompliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of, or recognize, the noncompliance.

.06 This section distinguishes the auditor's responsibilities regarding compliance with the following two categories of laws and regulations:

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[2]Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[3]Paragraph .A49 of section 200.

a. The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations (see paragraph .13)

b. The provisions of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be

   i. fundamental to the operating aspects of the business,

   ii. fundamental to an entity's ability to continue its business, or

   iii. necessary for the entity to avoid material penalties

(for example, compliance with the terms of an operating license, regulatory solvency requirements, or environmental regulations); therefore, noncompliance with such laws and regulations may have a material effect on the financial statements (see paragraph .14).

.07 In this section, differing requirements are specified for each of the previously mentioned categories of laws and regulations. For the category referred to in paragraph .06*a*, the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations. For the category referred to in paragraph .06*b*, the auditor's responsibility is limited to performing specified audit procedures that may identify noncompliance with those laws and regulations that may have a material effect on the financial statements.

.08 The auditor is required by this section to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may bring instances of identified or suspected noncompliance with laws and regulations to the auditor's attention. Maintaining professional skepticism throughout the audit, as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, is important in this context, given the extent of laws and regulations that affect the entity.[4]

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.10 The objectives of the auditor are to

a. obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of

[4]Paragraph .17 of section 200.

those laws and regulations generally recognized to have a direct effect on their determination (see paragraph .06*a*),

b. perform specified audit procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements (see paragraph .06*b*), and

c. respond appropriately to noncompliance or suspected noncompliance with laws and regulations identified during the audit.

Definition

.11 For the purposes of this section, the following term has the meaning attributed as follows:

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Requirements

The Auditor's Consideration of Compliance With Laws and Regulations

.12 As part of obtaining an understanding of the entity and its environment, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the auditor should obtain a general understanding of the following:[5] (Ref: par. .A8)

a. The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates

b. How the entity is complying with that framework

.13 The auditor should obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on their determination (see paragraph .06*a*). (Ref: par. .A9–.A11)

.14 The auditor should perform the following audit procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements (see paragraph .06*b*): (Ref: par. .A12–.A15)

[5]Paragraph .12 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

a. Inquiring of management and, when appropriate, those charged with governance about whether the entity is in compliance with such laws and regulations

b. Inspecting correspondence, if any, with the relevant licensing or regulatory authorities (Ref: par. .A16)

.15 During the audit, the auditor should remain alert to the possibility that other audit procedures applied may bring instances of noncompliance or suspected noncompliance with laws and regulations to the auditor's attention. (Ref: par. .A17–.A18)

.16 In the absence of identified or suspected noncompliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in paragraphs .12–.15 of this section and the requirement in section 580, *Written Representations*, related to requesting written representations from management regarding the entity's compliance with laws and regulations.[6]

Audit Procedures When Noncompliance Is Identified or Suspected

.17 If the auditor becomes aware of information concerning an instance of noncompliance or suspected noncompliance with laws and regulations, the auditor should obtain (Ref: par. .A19–.A20)

a. an understanding of the nature of the act and the circumstances in which it has occurred and

b. further information to evaluate the possible effect on the financial statements. (Ref: par. .A21)

.18 If the auditor suspects noncompliance may exist, the auditor should discuss the matter with management (at a level above those involved with the suspected noncompliance, if possible) and, when appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's professional judgment, the effect of the suspected noncompliance may be material to the financial statements, the auditor should consider the need to obtain legal advice. (Ref: par. .A22–.A23)

.19 If sufficient information about suspected noncompliance cannot be obtained, the auditor should evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

.20 The auditor should evaluate the implications of noncompliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations,[7] and take appropriate action. (Ref: par. .A24–.A25)

[6]Paragraph .13 of section 580, *Written Representations*.

[7]Paragraphs .22–.26 of section 580.

Reporting of Identified or Suspected Noncompliance

Reporting Noncompliance to Those Charged With Governance

.21 Unless all of those charged with governance are involved in management of the entity and aware of matters involving identified or suspected noncompliance already communicated by the auditor,[8] the auditor should communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential. (Ref: par. .A26)

.22 If, in the auditor's professional judgment, the noncompliance referred to in paragraph .21 is believed to be intentional and material, the auditor should communicate the matter to those charged with governance as soon as practicable.

.23 If the auditor suspects that management or those charged with governance are involved in noncompliance, the auditor should communicate the matter to the next higher level of authority at the entity, if it exists. When no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure about the person to whom to report, the auditor should consider the need to obtain legal advice.

Reporting Noncompliance in the Auditor's Report on the Financial Statements

.24 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 with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, express a qualified or adverse opinion on the financial statements.[9] (Ref: par. .A27)

.25 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 section 705.[10] (Ref: par. .A27)

.26 If the auditor is unable to determine whether noncompliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor should evaluate the effect on the auditor's opinion, in accordance with section 705.[11]

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[8]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[9]Paragraphs .08–.09 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[10][Footnote deleted, January 2012, to reflect conforming changes necessary due to the issuance of SAS No. 123.]

[11][Footnote deleted, January 2012, to reflect conforming changes necessary due to the issuance of SAS No. 123.]

Reporting Noncompliance to Regulatory and Enforcement Authorities

.27 If the auditor has identified or suspects noncompliance with laws and regulations, the auditor should determine whether the auditor has a responsibility to report the identified or suspected noncompliance to parties outside the entity. (Ref: par. .A28–.A29)

Documentation

.28 The auditor should include in the audit documentation a description of the identified or suspected noncompliance with laws and regulations and the results of discussion with management and, when applicable, those charged with governance and other parties inside or outside the entity.[12] (Ref: par. .A30)

Application and Other Explanatory Material

Responsibility for Compliance With Laws and Regulations (Ref: par. .03–.08)

Responsibility of Management

.A1 It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with laws and regulations. Laws and regulations may affect an entity's financial statements in different ways (for example, most directly, they may affect specific disclosures required of the entity in the financial statements, or they may prescribe the applicable financial reporting framework). They also may establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may provide for the imposition of penalties in cases of noncompliance.

.A2 The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of noncompliance with laws and regulations:

- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements
- Instituting and operating appropriate systems of internal control
- Developing, publicizing, and following a code of ethics or code of conduct
- Ensuring employees are properly trained and understand the code of ethics or code of conduct
- Monitoring compliance with the code of ethics or code of conduct and acting appropriately to discipline employees who fail to comply with it
- Engaging legal advisors to assist in monitoring legal requirements

[12] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints

In larger entities, these policies and procedures may be supplemented by assigning appropriate responsibilities to the following:

- An internal audit function
- An audit committee
- A legal function
- A compliance function

Responsibility of the Auditor

.A3 Because of the inherent limitations described in paragraph .05, an audit performed in accordance with GAAS provides no assurance that all noncompliance with laws and regulations will be detected or that any contingent liabilities that result will be disclosed.

.A4 Noncompliance by the entity with laws and regulations may result in a material misstatement of the financial statements. Detection of noncompliance, regardless of materiality, may affect other aspects of the audit, including, for example, the auditor's consideration of the integrity of management or employees. Noncompliance can result from fraudulent activity. Section 240, *Consideration of Fraud in a Financial Statement Audit*, addresses the auditor's responsibility if fraud or suspected fraud is detected.

.A5 Whether an act constitutes noncompliance with laws and regulations is a matter for legal determination, which ordinarily is beyond the auditor's professional competence to determine. Nevertheless, the auditor's training, experience, and understanding of the entity and its industry or sector may provide a basis to recognize that some acts coming to the auditor's attention may constitute noncompliance with laws and regulations.

.A6 In accordance with specific statutory requirements, the auditor may be specifically required to report, as part of the audit of the financial statements, on whether the entity complies with certain provisions of laws or regulations. In these circumstances, section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, and section 935, *Compliance Audits*, set forth how these audit responsibilities are addressed in the auditor's report. Furthermore, when specific statutory reporting requirements exist, it may be necessary for the audit plan to include appropriate tests for compliance with these provisions of the laws and regulations.

Considerations Specific to Governmental Entities

.A7 Auditors of governmental entities may have additional responsibilities with respect to the consideration of laws and regulations, which relate to the audit of financial statements or may extend to other aspects of the entity's operations.[13]

The Auditor's Consideration of Compliance With Laws and Regulations

Obtaining an Understanding of the Legal and Regulatory Framework (Ref: par. .12)

.A8 To obtain a general understanding of the legal and regulatory framework and how the entity complies with that framework, the auditor may, for example

- use the auditor's existing understanding of the entity's industry and regulatory and other external factors;
- update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
- inquire of management about other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;
- inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations (including the prevention of noncompliance), if appropriate;
- inquire of management regarding the policies or procedures adopted for identifying, evaluating, and accounting for litigation claims;
- inquire of management regarding the use of directives issued by the entity and periodic representations obtained by the entity from management at appropriate levels of authority concerning compliance with laws and regulations; and
- consider the auditor's knowledge of the entity's history of noncompliance with laws and regulations.

Laws and Regulations Generally Recognized to Have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements (Ref: par. .13)

.A9 Certain laws and regulations are well established, known to the entity and within the entity's industry or sector, and relevant to the entity's financial statements (as described in paragraph .06*a*). These laws and regulations generally are directly relevant to the determination of material amounts and disclosures in the financial statements and readily evident to the auditor. They could include those that relate to, for example

- the form and content of financial statements (for example, statutorily-mandated requirements);
- industry-specific financial reporting issues;
- accounting for transactions under government contracts (for example, laws and regulations that may affect the amount of revenue to be accrued); or
- the accrual or recognition of expenses for income tax or pension costs.

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[13]See section 935; *Government Auditing Standards*; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

.A10 Some provisions in those laws and regulations may be directly relevant to specific assertions in the financial statements (for example, the completeness of income tax provisions), whereas others may be directly relevant to the financial statements as a whole. The auditor's responsibility regarding misstatements resulting from noncompliance with laws and regulations having a direct effect on the determination of material amounts and disclosures in the financial statements is the same as that for misstatements caused by fraud or error, as described in section 200.

.A11 Noncompliance with other provisions of such laws and regulations, and the laws and regulations described in paragraph .06*b*, may result in fines, litigation, or other consequences for the entity, the costs of which may need to be provided for or disclosed in the financial statements but are not considered to have a direct effect on the financial statements, as described in paragraph .06*a*.

Procedures to Identify Instances of Noncompliance—Other Laws and Regulations (Ref: par. .14)

.A12 Certain other laws and regulations may need particular attention by the auditor because they have a fundamental effect on the operations of the entity (as described in paragraph .06*b*. Noncompliance with laws and regulations that have a fundamental effect on the operations of the entity may cause the entity to cease operations or call into question the entity's continuance as a going concern. For example, noncompliance with the requirements of the entity's license or other entitlement to perform its operations could have such an impact (for example, for a bank, noncompliance with capital or investment requirements).

.A13 Many laws and regulations relating principally to the operating aspects of the entity do not directly affect the financial statements (their financial statement effect is indirect) and are not captured by the entity's information systems relevant to financial reporting. Their indirect effect may result from the need to disclose a contingent liability because of the allegation or determination of identified or suspected noncompliance. Those other laws or regulations may include those related to securities trading, occupational safety and health, food and drug administration, environmental protection, equal employment, and price-fixing or other antitrust violations. An auditor may not have a sufficient basis for recognizing possible noncompliance with such laws and regulations.

.A14 For the category referred to in paragraph .06*b*, the auditor's responsibility is limited to performing specified audit procedures (see paragraph .14) that may identify noncompliance with those laws and regulations that may have a material effect on the financial statements. Even when those procedures are performed, the auditor may not become aware of the existence of noncompliance unless there is evidence of noncompliance in the records, documents, or other information normally inspected in an audit of financial statements.

.A15 Because the financial reporting consequences of other laws and regulations can vary depending on the entity's operations, the audit procedures required by paragraph .14 are intended to bring to the auditor's attention instances of noncompliance with laws and regulations that may have a material effect on the financial statements.

.A16 In some cases, the amount of an entity's correspondence with licensing or regulatory authorities is voluminous. In exercising professional judgment in such circumstances, the auditor may consider the following in determining the extent of inspection that may identify instances of noncompliance:

- The nature of the entity
- The nature and type of correspondence

Noncompliance Brought to the Auditor's Attention by Other Audit Procedures (Ref: par. .15)

.A17 Audit procedures applied to form an opinion on the financial statements may bring instances of noncompliance or suspected noncompliance with laws and regulations to the auditor's attention. For example, such audit procedures may include the following:

- Reading minutes
- Inquiring of the entity's management and in-house or external legal counsel concerning litigation, claims, and assessments
- Performing substantive tests of details of classes of transactions, account balances, or disclosures

.A18 Because the effect of laws and regulations on financial statements can vary considerably, written representations, as required by section 580, provide necessary audit evidence about management's knowledge of identified or suspected noncompliance with laws and regulations, the effects of which may have a material effect on the financial statements. However, written representations do not provide sufficient appropriate audit evidence on their own and, accordingly, do not affect the nature and extent of other audit evidence that is to be obtained by the auditor.[14]

Audit Procedures When Noncompliance Is Identified or Suspected

Indications of Noncompliance With Laws and Regulations (Ref: par. .17)

.A19 If the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of noncompliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties
- Payments for unspecified services or loans to consultants, related parties, employees, or government officials or government employees
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received

[14] Paragraph .04 of section 580.

- Purchases made at prices significantly above or below market price
- Unusual payments in cash, purchases in the form of cashiers' checks payable to bearer, or transfers to numbered bank accounts
- Unusual transactions with companies registered in tax havens
- Payments for goods or services made other than to the country from which the goods or services originated
- Existence of an information system that fails, whether by design or accident, to provide an adequate audit trail or sufficient evidence
- Unauthorized transactions or improperly recorded transactions
- Adverse media comment
- Noncompliance with laws or regulations cited in reports of examinations by regulatory agencies that have been made available to the auditor
- Failure to file tax returns or pay government duties or similar fees that are common to the entity's industry or the nature of its business

Obtaining an Understanding of an Act of Identified or Suspected Noncompliance (Ref: par. .17)

.A20 Procedures an auditor may perform to address the requirements of paragraph .17 include the following:

- Examining supporting documents, such as invoices, cancelled checks, and agreements, and comparing with accounting records
- Confirming significant information concerning the matter with the other party to the transaction or intermediaries, such as banks or lawyers
- Determining whether the transaction has been properly authorized
- Considering whether other similar transactions or events may have occurred and applying procedures to identify them

Matters Relevant to the Auditor's Evaluation (Ref: par. .17b)

.A21 Matters relevant to the auditor's evaluation of the possible effect on the financial statements include the following:

- The quantitative effect of noncompliance. The potential financial consequences of noncompliance with laws and regulations on the financial statements may include the imposition of fines, penalties, or damages; the threat of expropriation of assets; enforced discontinuation of operations; and litigation.
- The qualitative materiality of the effect of noncompliance. For example, an illegal payment of an otherwise immaterial amount could be material if a reasonable

possibility exists that it could lead to a material contingent liability or a material loss of revenue.

- Whether the potential financial consequences require accrual or disclosure under the applicable financial reporting framework. For example, if material revenue or earnings are derived from transactions involving noncompliance, or if noncompliance creates significant risks associated with material revenue or earnings, such as loss of a significant business relationship, that information may require disclosure. Loss contingencies resulting from noncompliance that may require disclosure may be evaluated in the same manner as other loss contingencies under the applicable financial reporting framework.

- Whether the potential financial consequences are so serious as to call into question the fair presentation of the financial statements or otherwise make the financial statements misleading.

Audit Procedures (Ref: par. .18)

.A22 The auditor may discuss the findings with those charged with governance, in which case they may be able to provide additional audit evidence. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the possibility of noncompliance with laws and regulations.

.A23 If management or, as appropriate, those charged with governance do not provide sufficient information to the auditor that the entity is in fact in compliance with laws and regulations, the auditor may consider it appropriate to consult with the entity's in-house legal counsel or external legal counsel about the application of the laws and regulations to the circumstances, including the possibility of fraud, and the possible effects on the financial statements. The auditor may request management to arrange for such consultation with the entity's legal counsel. If it is not considered appropriate to consult with the entity's legal counsel or if the auditor is not satisfied with the legal counsel's opinion, the auditor may consider it appropriate to consult the auditor's own legal counsel about whether a violation of a law or regulation is involved; the possible legal consequences, including the possibility of fraud; and what further action, if any, the auditor may take.

Evaluating the Implications of Noncompliance (Ref: par. .20)

.A24 As required by paragraph .20, the auditor evaluates the implications of noncompliance with regard to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular instances of noncompliance identified by the auditor will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls and the level of management or employees involved, especially implications arising from the involvement of the highest authority within the entity. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A25 The auditor may consider whether withdrawal from the engagement, when withdrawal is possible under applicable law or regulation, is necessary when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances, even when the noncompliance is not material to the financial statements. Factors that may affect the auditor's decision may include the implications of the failure to take remedial action, which may affect the auditor's ability to rely on management representations, and the effects of continuing association with the entity. When deciding whether withdrawal from the engagement is necessary, the auditor may consider seeking legal advice. If withdrawal from the engagement is not possible under applicable law or regulation, the auditor may consider alternative actions, including describing the noncompliance in an other-matter(s) paragraph in the auditor's report.[15]

Reporting of Identified or Suspected Noncompliance

Reporting Noncompliance to Those Charged With Governance (Ref: par. .21)

.A26 The communication of matters involving identified or suspected noncompliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The auditor may reach agreement in advance with those charged with governance on the nature of matters that would be considered clearly inconsequential and, thus, need not be communicated.

Issuance of a Modified Opinion on the Financial Statements (Ref: par. .24–.25)

.A27 If management or those charged with governance refuse to accept a modified opinion on the financial statements for the circumstances described in paragraphs .24–.25, the auditor may withdraw from the engagement, when withdrawal is possible under applicable law or regulation, and indicate the reasons for withdrawal in writing to those charged with governance.

Reporting Noncompliance to Regulatory and Enforcement Authorities (Ref: par. .27)

.A28 The auditor's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. However, the auditor's legal responsibilities vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to inquiries from an auditor to a predecessor auditor, in accordance with the requirements of section 210A, *Terms of Engagement*[16]
- In response to a court order
- In compliance with requirements for the audits of entities that receive financial assistance from a government agency

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[15]Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

[16]Paragraphs .11–.12 of section 210A, *Terms of Engagement*.

Because potential conflicts with the auditor's ethical and legal obligations for confidentiality may be complex, the auditor may consult with legal counsel before discussing noncompliance with parties outside the entity.

Considerations Specific to Governmental Entities

.A29 The auditor of a governmental entity may be required to report on compliance with laws, regulations, and provisions of contracts or grant agreements as part of the audit of the governmental entity's financial statements (for example, in an audit conducted in accordance with *Government Auditing Standards*). The auditor also may be required to communicate instances of noncompliance to appropriate oversight bodies and funding agencies.

Documentation (Ref: par. .28)

.A30 The auditor's documentation of findings regarding identified or suspected noncompliance with laws and regulations may include, for example

- copies of records or documents.
- minutes of discussions held with management, those charged with governance, or other parties inside or outside the entity.

AU-C Section 260

The Auditor's Communication With Those Charged With Governance

Source: SAS No. 122; SAS No. 123; SAS No. 125; SAS No. 128; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 143; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. Although this section applies regardless of an entity's governance structure or size, particular considerations apply when all of those charged with governance are involved in managing an entity. This section does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

.02 This section is written in the context of an audit of financial statements but may also be applied, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and fair presentation of the other historical financial information.

.03 Recognizing the importance of effective two-way communication in an audit of financial statements, this section provides an overarching framework for the auditor's communication with those charged with governance and identifies some specific matters to be communicated. Additional matters to be communicated are identified in other AU-C sections (see the exhibit, "Requirements to Communicate With Those Charged With Governance in Other AU-C Sections"). In addition, section 265, *Communicating Internal Control Related Matters Identified in an Audit*, establishes specific requirements regarding the communication of significant deficiencies and material weaknesses in internal control the auditor has identified during the audit to those charged with governance. Further matters not required by generally accepted auditing standards (GAAS) may be required to be communicated by agreement with those charged with governance or management or in accordance with law or regulation or other external requirements. Nothing in this section precludes the auditor from communicating any other matters to those charged with governance. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.05 The objectives of the auditor are to

a. communicate clearly with those charged with governance the responsibilities of the auditor regarding the financial statement audit and an overview of the planned scope and timing of the audit.

b. obtain from those charged with governance information relevant to the audit.

c. provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process.

d. promote effective two-way communication between the auditor and those charged with governance. (Ref: par. .A1–.A5)

Definitions

.06 For purposes of GAAS, the following terms have the meanings attributed as follows:

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance; for example, executive members of a governance board or an owner-manager.

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager.

Requirements

Those Charged With Governance

.07 The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Ref: par. .A6–.A9)

Communication With the Audit Committee or Other Subgroup of Those Charged With Governance

.08 If the auditor communicates with a subgroup of those charged with governance, such as the audit committee or an individual, the auditor should determine whether the auditor also needs to communicate with the governing body. (Ref: par. .A10–.A12)

When All of Those Charged With Governance Are Involved in Managing the Entity

.09 In some cases, all of those charged with governance are involved in managing the entity; for example, a small business in which a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this section are communicated with a person(s) with management responsibilities and that person(s) also has governance responsibilities, the matters need not be communicated again with the same person(s) in that person's governance role. These matters are noted in paragraph .14. The auditor should, nonetheless, be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit

.10 The auditor should communicate with those charged with governance the auditor's responsibilities with regard to the financial statement audit, including that (Ref: par. .A13–.A18)

a. the auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.

b. the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Planned Scope and Timing of the Audit

.11 The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: par. .A19–.A24) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Findings or Issues From the Audit

.12 The auditor should communicate with those charged with governance (Ref: par. .A25–.A26)

a. the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should (Ref: par. .A27–.A29)

    i. 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 most appropriate to the particular circumstances of the entity and

    ii. 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 conclusions regarding the reasonableness of those estimates.

b. significant unusual transactions, if any. (Ref: par. .A30)

c. significant difficulties, if any, encountered during the audit. (Ref: par. .A31)

d. disagreements with management, if any. (Ref: par. .A32)

e. circumstances that affect the form and content of the auditor's report, if any. (Ref: par. .A33–.A34)

f. matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.

g. other findings or issues, if any, arising during the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. .A35–.A37)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Uncorrected Misstatements

.13 The auditor should communicate with those charged with governance (Ref: par. .A38–.A39)

a. uncorrected misstatements accumulated by the auditor and the effect that they, 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.

b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

c. that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

When Not All of Those Charged With Governance Are Involved in Management

.14 Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate

a. material, corrected misstatements that were brought to the attention of management as a result of audit procedures. (Ref: par. .A40)

b. significant findings or issues arising during the audit that were discussed, or were the subject of correspondence, with management. (Ref: par. .A41)

c. the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred.

d. written representations the auditor is requesting. (Ref: par. .A42)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

The Communication Process

Establishing the Communication Process

.15 The auditor should communicate with those charged with governance the form, timing, and expected general content of communications. (Ref: par. .A43–.A47)

Forms of Communication

.16 The auditor should communicate in writing with those charged with governance significant findings or issues from the audit (see paragraphs .12–.14) if, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. (Ref: par. .A48–.A50)

.17 If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should communicate any omitted or inadequately described matters to those charged with governance. The auditor does not need to communicate them at the same level of detail as management, as long as the auditor (*a*) participated in management's discussion with those charged with governance, and (*b*) affirmatively confirmed to those charged with governance that management has adequately communicated these matters. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Restricted Use

.18 When the auditor communicates matters in accordance with this section in writing, the communication is considered a by-product report.[1] Accordingly, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management, and is not intended to be, and should not be, used by anyone other than these specified parties. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Timing of Communications

.19 The auditor should communicate with those charged with governance on a timely basis. (Ref: par. .A51–.A52) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Adequacy of the Communication Process

.20 The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, 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. (Ref: par. .A53–.A55) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Documentation

.21 When matters required to be communicated by this section have been communicated orally, the auditor should include them in the audit documentation, including when and to

[1] Paragraphs .06*c* and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

whom they were communicated.[2] When matters have been communicated in writing, the auditor should retain a copy of the communication as part of the audit documentation. If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should include a copy or summary of management's communications provided to those charged with governance in the audit documentation. (Ref: par. .A56) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Application and Other Explanatory Material

Objectives

The Role of Communication (Ref: par. .05)

.A1 This section focuses primarily on communications from the auditor to those charged with governance. Nevertheless, effective two-way communication is important in assisting

- the auditor and those charged with governance in understanding matters related to the audit in context and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- the auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events.
- those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

.A2 Although the auditor is responsible for communicating specific matters in accordance with this section, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the auditor does not relieve management of this responsibility. Similarly, management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.

.A3 Clear communication of specific matters required to be communicated by GAAS is an integral part of every audit. However, GAAS do not require the auditor to perform procedures specifically to identify other significant matters to communicate with those charged with governance.

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[2]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Legal or Regulatory Restrictions on Communicating With Those Charged With Governance (Ref: par. .05)

.A4 Law or regulation may restrict the auditor's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication or other action that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.

.A5 In certain circumstances, the auditor may be required to report to a regulatory or enforcement body certain matters that have been communicated with those charged with governance. For example, *Government Auditing Standards* requires auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to such parties in certain circumstances.

Those Charged With Governance (Ref: par. .07)

.A6 Governance structures vary by entity, reflecting influences such as size and ownership characteristics. For example:

- In some entities, those charged with governance hold positions (for example, company directors) that are integral parts of the entity's legal structure. For other entities, a body that is not part of the entity is charged with governance, as with some government agencies.
- In some cases, some or all of those charged with governance also have management responsibilities. In others, those charged with governance and management are different people.
- Parties charged with governance of governmental entities may include members or staff of a legislative oversight committee, oversight bodies, or other parties contracting for the audit.

.A7 In most entities, governance is the collective responsibility of a governing body, such as a board of directors; a supervisory board; partners; proprietors; a committee of management; trustees; or equivalent persons. In some smaller entities, however, one person may be charged with governance, such as the owner-manager, when there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup, such as an audit committee or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities.

.A8 Such diversity means that it is not possible for this section to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the engagement circumstances. An example of this is entities in which the governance structures are not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. When the appropriate person(s) with whom to communicate is not clearly identifiable, the auditor and the engaging party may need to discuss and agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

.A9 Section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, includes specific matters to be communicated by group auditors with those charged with governance.[3] When the entity being audited is a component of a group, the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

Communication With the Audit Committee or Other Subgroup of Those Charged With Governance (Ref: par. .08)

.A10 When considering communicating with a subgroup of those charged with governance, the auditor may take into account matters such as

- the respective responsibilities of the subgroup and the governing body.
- the nature of the matter to be communicated.
- relevant legal or regulatory requirements.
- whether the subgroup (*a*) has the authority to take action regarding the information communicated and (*b*) can provide further information and explanations the auditor may need.
- whether the auditor is aware of potential conflicts of interest between the subgroup and other members of the governing body.

.A11 When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in the terms of the engagement that the auditor retains the right to communicate directly with the governing body.

.A12 Audit committees (or similar subgroups with different names) exist in many entities. Although the specific authority and functions of audit committees may differ, communication with the audit committee, when one exists, is a key element in the auditor's communication with those charged with governance. Good governance principles suggest that

[3] Paragraphs .46–.49 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

- the auditor has access to the audit committee as necessary.
- the chair of the audit committee and, when relevant, the other members of the audit committee meet with the auditor periodically.
- the audit committee meets with the auditor without management present at least annually, unless prohibited by law or regulation.

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit (Ref: par. .10)

.A13 The auditor's responsibilities with regard to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that documents the terms of the engagement. Law, regulation, or the governance structure of the entity may require those charged with governance to agree upon the terms of the engagement with the auditor. When this is not the case, providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them regarding matters such as the following:

- That the auditor is responsible for performing the audit in accordance with GAAS, which are directed toward the expression of an opinion on the financial statements. The matters that GAAS require to be communicated, therefore, include significant matters arising during the audit of the financial statements that are relevant to those charged with governance in overseeing the financial reporting process.
- The fact that GAAS do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.
- That, when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the auditor is responsible for determining and communicating key audit matters in the auditor's report.
- That, when applicable, the auditor is also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Auditor Independence (Ref: par. .10)

.A14 GAAS require independence for all audits. Relevant matters to consider in reaching a conclusion about independence include circumstances or relationships that create threats to auditor independence and the related safeguards that have been applied to eliminate those threats or reduce them to an acceptable level. Comprehensive material on threats to independence and safeguards, including application to specific situations, is set forth in the AICPA's "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January

2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A15 Although the auditor's report affirms the auditor's independence, in certain situations, the auditor may determine that it is appropriate to communicate with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that, in the auditor's professional judgment, may reasonably be thought to bear on independence, and to which the auditor gave significant consideration, in reaching the conclusion that independence has not been impaired.

.A16 It may be particularly appropriate to communicate with those charged with governance those circumstances or relationships discussed in paragraph .A15 in audits of public interest entities. In addition to entities subject to Securities and Exchange Commission reporting requirements, all of the entities described in the definition of public interest entities in ET section 0.400, *Definitions*, are considered to be public interest entities. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A17 Relevant ethical requirements may also specify particular communications to those charged with governance in circumstances in which breaches of independence requirements have been identified. For example, the AICPA Code of Professional Conduct requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.[4] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A18 The form and timing of communications regarding independence may be affected by the entity's governance structure and whether a formal subgroup, such as an audit committee, exists. In situations in which all of those charged with governance are involved in managing the entity, the auditor may determine that those charged with governance have been informed of relevant facts regarding the auditor's independence through their management activities or through other means, such as the engagement letter. This is particularly likely when the entity is owner-managed and the auditor's firm has little involvement with the entity beyond a financial statement audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Planned Scope and Timing of the Audit (Ref: par. .11)

.A19 Communication regarding the planned scope and timing of the audit may assist

- those charged with governance to discuss issues of risk and materiality with the auditor;

[4] The "Breach of an Independence Interpretation" interpretation (ET sec. 1.298.010), under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct, addresses breaches of independence. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- those charged with governance to understand better the consequences of the auditor's work and to identify any areas in which they may request the auditor to undertake additional procedures; and
- the auditor to understand better the entity and its environment.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A20 Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they were determined to be significant risks. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A21 Other matters regarding the planned scope and timing of the audit may include the following:

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to the system of internal control, including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The application of materiality in the context of an audit, as discussed in section 320, *Materiality in Planning and Performing an Audit*. The auditor may wish to focus more broadly on the factors considered by the auditor when determining materiality for purposes of the audit, rather than on specific thresholds or amounts.
- The nature and extent of specialized skills or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor's expert.[5]
- When section 701 applies, the auditor's preliminary views about matters that may be areas of significant auditor attention in the audit and that therefore may be key audit matters.
- The auditor's planned approach to addressing the implications for the individual statements and the disclosures of any significant changes within the applicable financial reporting framework or in the entity's environment, financial condition, or activities.

[5]See section 620, *Using the Work of an Auditor's Specialist*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- If the entity has an internal audit function, how the auditor and the internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function in obtaining audit evidence and the nature and extent of any planned use of internal auditors to provide direct assistance.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 Other planning matters that may be appropriate to discuss with those charged with governance include

- the views of those charged with governance about the following matters:
  - — The appropriate person(s) in the entity's governance structure with whom to communicate
  - — The allocation of responsibilities between those charged with governance and management
  - — The entity's objectives and strategies and the related business risks that may result in material misstatements
  - — Matters those charged with governance consider as warranting particular attention during the audit and any areas for which they request additional procedures to be undertaken
  - — Significant communications between the entity and regulators
  - — Other matters those charged with governance believe are relevant to the audit of the financial statements
- the attitudes, awareness, and actions of those charged with governance concerning
  - — the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and
  - — the detection or the possibility of fraud.
- the actions of those charged with governance in response to developments in law, accounting standards, corporate governance practices, and other related matters, and the effect of such developments on, for example, the overall presentation, structure, and content of the financial statements, including the following:
  - — The relevance, reliability, comparability, and understandability of the information presented in the financial statements

  - — Whether all required information has been included in the financial statements, and whether such information has been appropriately classified, aggregated or disaggregated, and presented

- the actions of those charged with governance in response to previous communications with the auditor.
- if applicable, the document or documents that comprise the annual report and the planned manner and timing of the issuance of such documents in accordance with paragraph .13 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. When the auditor expects to obtain other information after the date of the auditor's report, the discussions with those charged with governance may also include the actions that may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.A23 Although communication with those charged with governance may assist the auditor to plan the scope and timing of the audit, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A24 Care is necessary when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly when some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A48 may be relevant in determining the nature and extent of this communication. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Findings From the Audit (Ref: par. .12)

.A25 The communication of significant findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A26 When section 701 applies, the communications with those charged with governance required by paragraph .12, as well as the communication about the significant risks identified by the auditor required by paragraph .11, are particularly relevant to the auditor's determination of matters that required significant auditor attention and that therefore may be key audit matters.[6] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: par. .12a)

.A27 Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures, for example, the use of assumptions in the development of accounting estimates. In addition, law, regulation, or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective, or complex judgments made by management in preparing the financial statements. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A28 As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph .A27, those charged with governance may be interested in the auditor's views on the degree to which complexity, subjectivity, or other inherent risk factors affect the selection or application of the methods, assumptions, and data used in making a significant accounting estimate, as well as the auditor's evaluation of whether management's point estimate and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may also include comment on the acceptability of significant accounting practices and the quality of the disclosures. When applicable, this may include whether a significant accounting practice of the entity relating to accounting estimates is considered by the auditor to not be the most appropriate to the particular circumstances of the entity, for example, when an alternative acceptable method for making an accounting estimate would, in the auditor's judgment, be more appropriate. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A29 Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. In communicating with those charged with governance about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the

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[6] Paragraphs .08–.09 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

auditor's conclusions regarding the reasonableness of those estimates, the auditor may consider communicating

- the nature of significant assumptions,
- the degree of subjectivity involved in the development of the assumptions, and
- the relative materiality of the items being measured to the financial statements as a whole.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Significant Unusual Transactions (Ref. par. .12b)

.A30 The communication of significant unusual transactions may include

- the auditor’s views on the policies and practices management used to account for significant unusual transactions; and
- the auditor's understanding of the business purpose for significant unusual transactions.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Significant Difficulties Encountered During the Audit (Ref: par. .12c)

.A31 Significant difficulties encountered during the audit may include matters such as

- significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary to perform the auditor’s procedures.
- an unreasonably brief time within which to complete the audit.
- extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- the unavailability of expected information.
- restrictions imposed on the auditor by management.
- management’s unwillingness to perform or extend its evaluation of the entity’s ability to continue as a going concern to meet the period of time required by the applicable financial reporting framework when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor’s opinion. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Disagreements With Management (Ref: par. .12d)

.A32 Discussions with those charged with governance include any disagreements with management that arose during the audit, 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. Disagreements with management may occasionally arise over, among other things, the application of accounting principles to the entity's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. For purposes of this section, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Circumstances That Affect the Form and Content of the Auditor's Report (Ref: par. .12e)

.A33 Section 210A, *Terms of Engagement*, requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate.[7] The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report.[8] As explained in paragraph .A13, if the terms of engagement are not agreed upon with those charged with governance, the auditor may provide those charged with governance with a copy of the engagement letter in order to communicate about matters relevant to the audit. The communication required by paragraph .12*e* is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A34 Circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with GAAS, and for which communication with those charged with governance is required, include the following:

- The auditor expects to modify the opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.[9]

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[7]Paragraph .09 of section 210A, *Terms of Engagement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[8]Paragraph .10 of section 210A. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[9]Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- A "Going Concern" section is included in the auditor's report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.[10]
- Key audit matters are communicated in accordance with section 701.[11]
- The auditor considers it necessary to include an emphasis-of-matter paragraph or other-matter paragraph in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*,[12] or is required to do so by other AU-C sections.

In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate a discussion of how such matters will be addressed in the auditor's report. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Other Findings or Issues

.A35 The auditor may become aware that the entity is subject to an audit requirement that is not encompassed in the terms of the engagement. The communication to those charged with governance that an audit conducted in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements may be necessary if, for example, an entity engages an auditor to perform an audit of its financial statements in accordance with GAAS and the auditor becomes aware that by law, regulation, or contractual agreement the entity also is required to have an audit performed in accordance with one or more of the following:

a. *Government Auditing Standards*

b. Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administration Requirements, Cost Principles, Audit Requirements for Federal Awards*

c. Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

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[10]Paragraphs .24 and .28 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[11]Paragraph .16 of section 701. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[12]Paragraph .12 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Other Significant Matters Relevant to the Financial Reporting Process (Ref: par. .12g)

.A36 Section 300, *Planning an Audit*,[13] notes that, as a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and, thereby, the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The auditor may communicate with those charged with governance about such matters as, for example, an update to initial discussions about the planned scope and timing of the audit. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A37 To the extent not already addressed by the requirements in paragraph .12*a–f* and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.[14] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Uncorrected Misstatements (Ref: par. .13)

.A38 The auditor is not required to accumulate misstatements that the auditor believes are trivial.[15] 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 individual uncorrected misstatement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A39 The auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, taking into account the size and nature of the misstatement judged in the surrounding circumstances, and possible implications with regard to future financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Corrected Misstatements (Ref: par. .14a)

.A40 The auditor also may communicate corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements. [Paragraph renumbered by the issuance of SAS No.

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[13]Paragraph .A15 of section 300, *Planning an Audit*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[14]Paragraphs .21–.22 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[15]Paragraph .05 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

*Significant Findings or Issues Discussed or Subject to Correspondence With Management (Ref: par. .14*b*)*

.A41 Significant findings or issues discussed, or the subject of correspondence, with management may include matters such as

- significant events or transactions that occurred during the year.
- business conditions affecting the entity and business plans and strategies that may affect the risks of material misstatement.
- discussions or correspondence in connection with the initial or recurring engagement of the auditor including, among other matters, any discussions or correspondence regarding accounting practices or the application of auditing standards.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Written Representations (Ref: par. .14d)

.A42 The auditor may provide those charged with governance with a copy of management's written representations. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

The Communication Process

Establishing the Communication Process (Ref: par. .15)

.A43 Clear communication of the following helps establish the basis for effective two-way communication:

- The auditor's responsibilities (paragraphs .10 and .A13–.A17)
- An overview of the planned scope and timing of the audit (paragraphs .11 and .A18–.A22)
- The expected general content of communications

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A44 Matters that may also contribute to effective two-way communication include discussion of

- the purpose of communications. When the purpose is clear, the auditor and those charged with governance are in a better position to have a mutual understanding of relevant issues and the expected actions arising from the communication process.
- the form in which communications will be made.
- the person(s) on the audit team and among those charged with governance who will communicate regarding particular matters.
- the auditor's expectation that communication will be two-way and that those charged with governance will communicate with the auditor matters they consider relevant to the audit. Such matters might include (*a*) strategic decisions that may significantly affect the nature, timing, and extent of audit procedures; (*b*) the suspicion or the detection of fraud; or (*c*) concerns with the integrity or competence of senior management.
- the process for taking action and reporting back on matters communicated by the auditor.
- the process for taking action and reporting back on matters communicated by those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A45 The communication process will vary with the circumstances, including the size and governance structure of the entity, how those charged with governance operate, and the auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph .A53). [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Communication With Management

.A46 Many matters may be discussed with management in the ordinary course of an audit, including matters to be communicated with those charged with governance in accordance with this section. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation and fair presentation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A47 Before communicating matters with those charged with governance, the auditor may discuss them with management unless that is inappropriate. For example, it may not be appropriate to discuss with management questions of management's competence or integrity. In addition to recognizing management's responsibility, these initial discussions may clarify facts and issues and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the auditor may discuss matters with appropriate individuals within the function before communicating with those charged with governance. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Forms of Communication (Ref: par. .16)

.A48 Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions. The auditor may communicate matters other than those identified in paragraph .16 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A49 In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a formal or informal manner) may be affected by factors such as

- whether a discussion of the matter will be included in the auditor's report. (For example, when key audit matters are communicated in the auditor's report, the auditor may consider it necessary to communicate in writing about the matters determined to be key audit matters.)
- whether the matter has been satisfactorily resolved.
- whether management has previously communicated the matter.
- the size, operating structure, control environment, and legal structure of the entity being audited.
- in the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.
- legal or regulatory requirements that may require a written communication with those charged with governance.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- the amount of ongoing contact and dialogue the auditor has with those charged with governance.
- whether there have been significant changes in the membership of a governing body.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A50 When a significant matter is discussed with an individual member of those charged with governance, such as the chair of an audit committee, it may be appropriate for the auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Timing of Communications (Ref: par. .19)

.A51 Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The following are examples of the timing of communications for certain matters:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- It may be appropriate to communicate significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- When section 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.

The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor's report:

- Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor's report, including possible implications with respect to future financial statements
- Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired
- Significant findings or issues from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices
- An expectation by the auditor that the opinion in the auditor's report will be modified in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*[16]
- When section 701 applies, the matters planned to be included in the auditor's report

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A52 Other factors that may be relevant to the timing of communications include

- the size, operating structure, control environment, and legal structure of the entity being audited.
- any legal obligation to communicate certain matters within a specified timeframe.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- the time at which the auditor identifies certain matters (for example, timely communication of a material weakness to enable appropriate remedial action to be taken).
- whether the auditor is auditing both general purpose and special purpose financial statements.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Adequacy of the Communication Process (Ref: par. .20)

.A53 The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance. Rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include

- the appropriateness and timeliness of actions taken by those charged with governance in response to matters communicated by the auditor. When significant findings or issues raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to inquire about why appropriate action has not been taken and to consider raising the point again. This avoids the risk of giving an impression that the auditor is satisfied that the matter has been adequately addressed or is no longer significant.
- 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.

[16] Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- the apparent ability of those charged with governance to fully comprehend matters raised 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.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A54 As discussed in paragraph .A1, effective two-way communication assists both the auditor and those charged with governance. Further, section 315A identifies participation by those charged with governance, including their interaction with the internal audit function (if any) and external auditors, as an element of the entity's control environment. 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. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A55 If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take actions such as the following:

- Modifying the auditor's opinion on the basis of a scope limitation
- Obtaining legal advice about the consequences of different courses of action
- Communicating with third parties (for example, a regulator) or a higher authority in the governance structure that is outside the entity, such as the owners of a business (for example, shareholders in a general meeting), or the responsible government agency for certain governmental entities
- Withdrawing from the engagement when withdrawal is possible under applicable law or regulation

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Documentation (Ref: par. .21)

.A56 Documentation of oral communication may include a copy of minutes prepared by the entity as part of the audit documentation if those minutes are an appropriate record of the communication. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Appendix — Qualitative Aspects of Accounting Practices

.A57 The communication required by paragraph .12*a* and discussed in paragraphs .A27–.A29 may include such matters as the following:

Accounting Policies

- The appropriateness of the accounting policies to the particular circumstances of the entity, considering the need to balance the cost of providing information with the likely benefit to users of the entity's financial statements (when acceptable alternative accounting policies exist, the communication may include identification of the financial statement items that are affected by the choice of significant policies as well as information on accounting policies used by similar entities)
- The initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements (the communication may include the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and the timing of a change in accounting policies with regard to expected new accounting pronouncements)
- The effect of significant accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative material or consensus)
- The effect of the timing of transactions in relation to the period in which they are recorded

Accounting Estimates and Related Disclosures

- Appendix B, "Communications With Those Charged With Governance," of section 540, Auditing Accounting Estimates and Related Disclosures, includes matters that the auditor may consider communicating with respect to significant qualitative aspects of the entity's accounting practices related to accounting estimates and related disclosures.

Financial Statement Disclosures

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (for example, disclosures related to revenue recognition, going concern, subsequent events, and contingency issues)
- The overall neutrality, consistency, and clarity of the disclosures in the financial statements

Related Matters

- The potential effect on the financial statements of significant risks and exposures and uncertainties, such as pending litigation, that are disclosed in the financial statements

- The extent to which the financial statements are affected by unusual transactions, including nonrecurring amounts recognized during the period, and the extent to which such transactions are separately disclosed in the financial statements
- The factors affecting asset and liability carrying values, including the entity's bases for determining useful lives assigned to tangible and intangible assets (the communication may explain how factors affecting carrying values were selected and how alternative selections would have affected the financial statements
- The selective correction of misstatements (for example, correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

.A58 Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

a. paragraph .17 of section 210A, *Terms of Engagement*

b. paragraphs .21, .38*c*i, and .39–.41 of section 240, *Consideration of Fraud in a Financial Statement Audit*

c. paragraphs .14, .18, and .21–.23 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

d. paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*

e. paragraph .27 of section 550, *Related Parties*

f. paragraphs .10*b*–*c*, .12*a*, .15*a*, .17*a*, and .18 of section 560, *Subsequent Events and Subsequently Discovered Facts*

g. paragraph .37 of section 540, *Auditing Accounting Estimates and Related Disclosures*

h. paragraph .28 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

i. paragraphs .46–.49 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

j. paragraph .28 of section 610, *Using the Work of Internal Auditors*

k. paragraph .16 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

l. paragraphs .12, .14, .24, and .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*

m. paragraph .12 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

n. paragraphs .15, .20*b*, and .21*a* of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

o. paragraph .06 of section 730, *Required Supplementary Information*

p. paragraphs .23–.28 of section 930, *Interim Financial Information*

q. paragraphs .36–.37 of section 935, *Compliance Audits*

[Revised, September 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

AU-C Section 265

Communicating Internal Control Related Matters Identified in an Audit

Source: SAS No. 122; SAS No. 125; SAS No. 128; SAS No. 130; SAS No. 135; SAS No. 145.

See section 9265 for interpretations of this section.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. This section does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control or designing and performing tests of controls over and above the requirements of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. Section 260, *The Auditor's Communication With Those Charged With Governance*, establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance regarding the audit. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.02 The auditor is required to obtain an understanding of the entity's system of internal control when identifying and assessing the risks of material misstatement.[1] In making those risk assessments, the auditor considers the entity's system of internal control 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 internal control. The auditor may identify deficiencies in internal control (commonly referred to as control deficiencies) not only during this risk assessment process but also at any other stage of the audit. This section specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[1]Paragraphs 21–22 and 24–26 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.03 Nothing in this section precludes the auditor from communicating to those charged with governance or management other internal control matters that the auditor has identified during the audit.

.04 This section is not applicable if the auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. In such circumstances, section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, applies. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SAS No. 130.]

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.06 The objective of the auditor is to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Deficiency in internal control. A deficiency in internal control over financial reporting 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 properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly 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. (Ref: par. .A1)

Material weakness. A deficiency, or a 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 reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

> **Reasonably possible.** The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.

Significant deficiency. 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.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Requirements

Determination of Whether Deficiencies in Internal Control Have Been Identified

.08 The auditor should determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. (Ref: par. .A2–.A5)

Evaluating Identified Deficiencies in Internal Control (Ref: par. .A6–.A15)

.09 If the auditor has identified one or more deficiencies in internal control, the auditor should evaluate each deficiency to determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies or material weaknesses.

.10 If the auditor initially 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. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Communication of Deficiencies in Internal Control

.11 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. (Ref: par. .A16–.A21 and .A29)

.12 The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis (Ref: par. .A22 and .A29)

a. 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. (Ref: par. .A17 and .A23–.A24)

b. 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. (Ref: par. .A25–.A28)

.13 The communications referred to in paragraphs .11–.12 should be made no later than 60 days following the report release date. (Ref: par. .A17–.A18)

.14 The auditor should include in the auditor's written communication of significant deficiencies and material weaknesses (Ref: par. .A30–.A34)

a. the definition of the term *material weakness* and, when relevant, the definition of the term *significant deficiency*.

b. a description of the significant deficiencies and material weaknesses and an explanation of their potential effects. (Ref: par. .A30)

c. sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor should include in the communication the following elements that explain that (Ref: par. .A31–.A32)

   i. the purpose of the audit was for the auditor to express an opinion on the financial statements.

   ii. the audit included consideration of internal control over financial reporting 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 internal control.

   iii. the auditor is not expressing an opinion on the effectiveness of internal control.

   iv. the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified.

d. an appropriate alert, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.[2] (Ref: par. .A33)

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.15 When the auditor issues a written communication stating that no material weaknesses were identified during the audit, the communication should include the matters in paragraph .14*a* and *c*–*d*. (Ref: par. .A35–.A37)

[2]Paragraphs .06*c*, .07, and .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.16 The auditor should not issue a written communication stating that no significant deficiencies were identified during the audit. (Ref: par. .A35)

Application and Other Explanatory Material

Determination of Whether Deficiencies in Internal Control Have Been Identified (Ref: par. .08)

.A1 SAS No. 145 defines the term *system of internal control* and recognizes that internal control frameworks may use different terms that are similar to the concept of the system of internal control. This section defines the term *deficiency in internal control* in the context of a system of internal control over financial reporting to more clearly define the auditor's communication responsibilities in this section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A2 In determining whether the auditor has identified one or more deficiencies in internal control, the auditor may discuss the relevant facts and circumstances of the auditor's findings with the appropriate level of management. This discussion provides an opportunity for the auditor to alert management on a timely basis to the existence of deficiencies of which management may not have been previously aware. The level of management with whom it is appropriate to discuss the findings is one that is familiar with the internal control area concerned and that has the authority to take remedial action on any identified deficiencies in internal control. In some circumstances, it may not be appropriate for the auditor to discuss the auditor's findings directly with management (for example, if the findings appear to call management's integrity or competence into question [see paragraph .A23]). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A3 In discussing the facts and circumstances of the auditor's findings with management, the auditor may obtain other relevant information for further consideration, such as

- management's understanding of the actual or suspected causes of the deficiencies.
- exceptions arising from the deficiencies that management may have noted (for example, misstatements that were not prevented by the relevant IT controls).
- a preliminary indication from management of its response to the findings.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Smaller, Less Complex Entities

.A4 Although the concepts underlying controls in the control activities component in smaller entities are likely to be similar to those in larger entities, the formality with which controls operate will vary. Further, smaller entities may find that certain types of controls are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed controls. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A5 Also, smaller entities often have fewer employees, which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. On the other hand, such increased management oversight also may increase the risk of management override of controls. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Evaluating Identified Deficiencies in Internal Control (Ref: par. .09–.10)

.A6 The severity of a deficiency, or a combination of deficiencies, in internal control 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.

Significant deficiencies and material weaknesses may exist even though the auditor has not identified misstatements during the audit. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A7 Factors that affect the magnitude of a misstatement that might result from a deficiency, or deficiencies, in internal control include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected in future periods) in the class of transactions or account balance exposed to the deficiency

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A8 In evaluating the magnitude of the potential misstatement, the maximum amount by which an account balance or total of transactions can be overstated generally is the recorded amount, whereas understatements could be larger. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A9 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in internal control will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:

- The nature of the financial statement classes of transactions, account balances, disclosures, and assertions involved

- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in internal control
- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in internal control
- The possible future consequences of the deficiency, or deficiencies, in internal control
- The importance of the controls, such as the following, to the financial reporting process:
  - — General monitoring controls (such as oversight of management)
  - — Controls over the prevention and detection of fraud
  - — Controls over the selection and application of significant accounting policies
  - — Controls over significant transactions with related parties
  - — Controls over significant unusual transactions
  - — Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A10 The evaluation of whether a deficiency in internal control presents a reasonable possibility of misstatement may be made without quantifying the probability of occurrence as a specific percentage or range. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A11 Controls may be designed to operate individually, or in combination, to effectively prevent, or detect and correct, misstatements.[3] For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency or a material weakness. However, a combination of deficiencies affecting the same class of transactions, account balance, or disclosure, assertion, or component of the entity's system of internal control may increase the risks of misstatement to such an extent to give rise to a significant deficiency or material weakness. [As amended, effective for audits for

[3]Paragraph .A68 of section 315A. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

periods ending on or after December 15, 2016, by SAS No. 130. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A12 Indicators of material weaknesses in internal control include

- identification of fraud, whether or not material, on the part of senior management. For the purpose of this indicator, the term "senior management" includes the principal executive and financial officers as well as any other members of senior management who play a significant role in the entity's financial reporting process;
- restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error;
- identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's internal control; and
- ineffective oversight of the entity's financial reporting and internal control by those charged with governance.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]]

Considerations Specific to Governmental Entities

.A13 Law or regulation may require the auditor to communicate to those charged with governance or other relevant parties (such as regulators) deficiencies in internal control that the auditor has identified during the audit using specific terms and definitions that differ from those in this section. In such circumstances, the auditor uses such terms and definitions when communicating deficiencies in internal control in accordance with the requirements of the law or regulation and in accordance with this section. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A14 When law or regulation requires the auditor to communicate deficiencies in internal control that the auditor has identified during the audit using specific terms, but such terms have not been defined, the auditor may use the definitions, requirements, and guidance in this section to comply with the law or regulation. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A15 The requirements of this section remain applicable, notwithstanding that law or regulation may require the auditor to use specific terms or definitions. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Communication of Deficiencies in Internal Control (Ref: par. .11–.16)

Communication of Significant Deficiencies and Material Weaknesses to Those Charged With Governance (Ref: par. .11)

.A16 Communicating significant deficiencies and material weaknesses in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities. Section 260 establishes relevant considerations regarding communication with those charged with governance when all of them are involved in managing the entity.[4] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A17 Although the auditor is required by paragraph .13 to make the communications referred to in paragraphs .11–.12 no later than 60 days following the report release date, the communication is best made by the report release date because receipt of such communication may be an important factor in enabling those charged with governance to discharge their oversight responsibilities. Nevertheless, because the auditor's written communication of significant deficiencies and material weaknesses forms part of the final audit file, the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis, no later than 60 days following the report release date.[5] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A18 Early communication to those charged with governance or management may be important for some matters because of their relative significance and the urgency for corrective follow-up action. Regardless of the timing of the written communication of significant deficiencies and material weaknesses, the auditor may communicate these orally in the first instance to management and, when appropriate, those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. However, oral communication does not relieve the auditor of the responsibility to communicate the significant deficiencies and material weaknesses in writing, as this section requires. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A19 The level of detail at which to communicate significant deficiencies and material weaknesses is a matter of the auditor's professional judgment in the circumstances. Factors that the auditor may consider in determining an appropriate level of detail for the communication include, for example, the following:

- The nature of the entity. For example, the communication required for a governmental entity may be different from that for a nongovernmental entity.
- The size and complexity of the entity. For example, the communication required for a complex entity may be different from that for an entity operating a simple business.
- The nature of significant deficiencies and material weaknesses that the auditor has identified.
- The entity's governance composition. For example, more detail may be needed if those charged with governance include members who do not have significant experience in the entity's industry or in the affected areas.

[4]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

[5]Paragraph .16 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

- Legal or regulatory requirements regarding the communication of specific types of deficiencies in internal control.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A20 Management and those charged with governance may already be aware of significant deficiencies and material weaknesses that the auditor has identified during the audit and may have chosen not to remedy them because of cost or other considerations. The responsibility for evaluating the costs and benefits of implementing remedial action rests with management and those charged with governance. Accordingly, the requirements to communicate significant deficiencies and material weaknesses in paragraphs .11–.12 apply, regardless of cost or other considerations that management and those charged with governance may consider relevant in determining whether to remedy such deficiencies. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A21 The fact that the auditor communicated a significant deficiency or material weakness to those charged with governance and management in a previous audit does not eliminate the need for the auditor to repeat the communication if remedial action has not yet been taken. If a previously communicated significant deficiency or material weakness remains, the current year's communication may repeat the description from the previous communication or simply reference the previous communication and the date of that communication. The auditor may ask management or, when appropriate, those charged with governance why the significant deficiency or material weakness has not yet been remedied. A failure to act, in the absence of a rational explanation, may in itself represent a significant deficiency or material weakness. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Communication of Deficiencies in Internal Control to Management (Ref: par. .12)

.A22 Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the deficiencies in internal control and to take the necessary remedial action. For significant deficiencies and material weaknesses, the appropriate level is likely to be the CEO or CFO (or equivalent) because these matters also are required to be communicated to those charged with governance. For other deficiencies in internal control, the appropriate level may be operational management with more direct involvement in the control areas affected and with the authority to take appropriate remedial action. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Communication of Significant Deficiencies and Material Weaknesses in Internal Control to Management (Ref: par. .12a)

.A23 Certain identified significant deficiencies or material weaknesses in internal control may call into question the integrity or competence of management. For example, there may be evidence of fraud or intentional noncompliance with laws and regulations by management or management may exhibit an inability to oversee the preparation of adequate financial statements, which may raise doubt about management's competence. Accordingly, it may not be appropriate to communicate such deficiencies directly to management. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A24 Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, establishes requirements and provides guidance on the reporting of identified or suspected noncompliance with laws and regulations, including when those charged with governance are themselves involved in such noncompliance.[6] Section 240, *Consideration of Fraud in a Financial Statement Audit*, establishes requirements and provides guidance regarding communication to those charged with governance when the auditor has identified fraud or suspected fraud involving management.[7]

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Communication of Other Deficiencies in Internal Control to Management (Ref: par. .12b)

.A25 During the audit, the auditor may identify other deficiencies in internal control that are not significant deficiencies or material weaknesses but that may be of sufficient importance to merit management's attention. The determination regarding which other deficiencies in internal control merit management's attention is a matter of the auditor's professional judgment in the circumstances, taking into account the likelihood and potential magnitude of misstatements that may arise in the financial statements as a result of those deficiencies. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A26 The communication of other deficiencies in internal control that merit management's attention need not be in writing. When the auditor has discussed the facts and circumstances of the auditor's findings with management, the auditor may consider an oral communication of the other deficiencies to have been made to management at the time of these discussions. Accordingly, a formal communication need not be made subsequently. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A27 If the auditor has communicated deficiencies in internal control, other than significant deficiencies or material weaknesses, to management in a prior period and management has chosen not to remedy them for cost or other reasons, the auditor need not repeat the communication in the current period. The auditor also is not required to repeat information about such deficiencies if the information has been previously communicated to management by other parties, such as the internal audit function or regulators. However, the auditor may consider it appropriate to recommunicate these other deficiencies if there has been a change of management or if new information has come to the auditor's attention that alters the prior understanding of the auditor and management regarding the deficiencies. Nevertheless, the failure of management to remedy other deficiencies in internal control that were previously communicated may become a significant deficiency requiring communication with those charged with governance. Whether this is the case depends on the auditor's professional judgment in the circumstances. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

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[6] Paragraphs .21–.27 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

[7] Paragraph .40 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

.A28 In some circumstances, those charged with governance may wish to be made aware of the details of other deficiencies in internal control that the auditor has communicated to management or be briefly informed of the nature of the other deficiencies. Alternatively, the auditor may inform those charged with governance when a communication of other deficiencies has been made to management. In either case, the auditor may communicate orally or in writing to those charged with governance, as appropriate. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Governmental Entities (Ref: par. .11–.12)

.A29 Auditors performing audits of governmental entities may have additional responsibilities to communicate deficiencies in internal control that the auditor identified during the audit, in a different format, at a level of detail or to parties not envisioned in this section. For example, significant deficiencies and material weaknesses may have to be communicated to a governmental authority, and such communications may be required to be made publicly available. Law or regulation also may require auditors to report deficiencies in internal control, irrespective of their severity. Further, law or regulation may require auditors to report on broader internal control-related matters (for example, controls related to compliance with law, regulation, or provisions of contracts or grant agreements).[8]

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Content of Written Communication of Significant Deficiencies and Material Weaknesses in Internal Control (Ref: par. .14–.16)

.A30 In explaining the potential effects of the significant deficiencies and material weaknesses, the auditor need not quantify those effects. The potential effects may be described in terms of the control objectives and types of errors the control was designed to prevent, or detect and correct, or in terms of the risk(s) of misstatement that the control was designed to address. The potential effects may be evident from the description of the significant deficiencies or material weaknesses. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A31 The significant deficiencies or material weaknesses may be grouped together for reporting purposes when it is appropriate to do so. The auditor also may include in the written communication suggestions for remedial action on the deficiencies, management's actual or proposed responses, and a statement about whether the auditor has undertaken any steps to verify whether management's responses have been implemented (see paragraph .A34). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A32 The auditor may consider it appropriate to include the following information as additional context for the communication:

- The general inherent limitations of internal control, including the possibility of management override of controls

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[8] See section 935, *Compliance Audits*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

- The specific nature and extent of the auditor's consideration of internal control during the audit

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Restriction on Use (Ref: par. .14d)

.A33 In certain cases not involving *Government Auditing Standards*, law or regulation may require the auditor or management to furnish a copy of the auditor's written communication on significant deficiencies and material weaknesses to governmental authorities. When this is the case, the auditor's written communication may identify such governmental authorities in the paragraph containing the alert that restricts the use of the auditor's written communication. Section 905 does not permit the auditor to add parties, other than those identified in paragraph .07*b* of that section.[9] [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Management's Written Response

.A34 Management may wish to or may be required by a regulator to prepare a written response to the auditor's communication regarding significant deficiencies or material weaknesses identified during the audit. Such management communications may include 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 such a written response is included in a document containing the auditor's written communication to management and those charged with governance concerning identified significant deficiencies or material weaknesses, the auditor may add a paragraph to the written communication disclaiming an opinion on such information. The following is an example of such a paragraph:

> ABC Company's written response to the significant deficiencies [*and material weaknesses*] identified in our audit was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

No Material Weakness Communications (Ref: par. .15–.16)

.A35 Management or those charged with governance may request a written communication indicating that no material weaknesses were identified during the audit. A written communication indicating that no material weaknesses were identified during the audit does not provide any assurance about the effectiveness of an entity's internal

[9] Paragraph .08 of section 905. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

control over financial reporting. However, an auditor is not precluded from issuing such a communication, provided that the communication includes the matters required by paragraph .15. However, a written communication indicating that no significant deficiencies were identified during the audit is precluded by paragraph .16 because such a communication has the potential to be misunderstood or misused. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A36 Exhibit B, "Illustrative No Material Weakness Communication," includes an illustrative communication indicating that no material weaknesses were identified during the audit. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Governmental Entities

.A37 A written communication indicating that no material weaknesses were identified during the audit may be required to be furnished to governmental authorities. As described in paragraph .A33, the auditor's written communication may identify the governmental authority as a specified party in the restricted use paragraph. The auditor is not permitted to add other parties as specified parties. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Appendix — Examples of Circumstances That May Be Deficiencies, Significant Deficiencies, or Material Weaknesses

.A38 Paragraph .A12 identifies indicators of material weaknesses in internal control. The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses.

Deficiencies in the Design of Controls

The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses related to the design of controls:

- Inadequate design of controls over the preparation of the financial statements being audited.
- Inadequate design of controls over a significant account or process.
- Inadequate documentation of the components of internal control.
- Insufficient control consciousness within the organization (for example, the tone at the top and the control environment).
- Evidence of ineffective aspects of the control environment, such as indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (for example, absence of controls over such a risk).
- Absent or inadequate segregation of duties within a significant account or process.
- Absent or inadequate controls over the safeguarding of assets (this applies to controls that the auditor determines would be necessary for effective internal control over financial reporting).
- Inadequate design of IT general and application controls that prevents the information system from providing complete and accurate information consistent with financial reporting objectives and current needs.
- Employees or management who lack the qualifications and training to fulfill their assigned functions. For example, in an entity that prepares financial statements in accordance with generally accepted accounting principles (GAAP), the person responsible for the accounting and reporting function lacks the skills and knowledge to apply GAAP in recording the entity's financial transactions or preparing its financial statements.

- Inadequate design of monitoring controls used to assess the design and operating effectiveness of the entity's internal control over time.
- Absence of an internal process to report deficiencies in internal control to management on a timely basis.
- Absence of a risk assessment process within the entity when such a process would ordinarily be expected to have been established.

Failures in the Operation of Controls

The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses related to the operation of controls:

- Failure in the operation of effectively designed controls over a significant account or process (for example, the failure of a control such as dual authorization for significant disbursements within the purchasing process).
- Failure of the information and communication component of internal control to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy (for example, the failure to obtain timely and accurate consolidating information from remote locations that is needed to prepare the financial statements).
- Failure of controls designed to safeguard assets from loss, damage, or misappropriation. This circumstance may need careful consideration before it is evaluated as a significant deficiency or material weakness. For example, assume that a company uses security devices to safeguard its inventory (preventive controls) and also performs timely periodic physical inventory counts (detective control) with regard to its financial reporting. Although the physical inventory count does not safeguard the inventory from theft or loss, it prevents a material misstatement of the financial statements if performed effectively and timely. Therefore, given that the definitions of *material weakness* and *significant deficiency* relate to the likelihood of misstatement of the financial statements, the failure of a preventive control, such as inventory tags, will not result in a significant deficiency or material weakness if the detective control (physical inventory counts) prevents a misstatement of the financial statements. Material weaknesses relating to controls over the safeguarding of assets would only exist if the company does not have effective controls (considering both safeguarding and other controls) to prevent, or detect and correct, a material misstatement of the financial statements.
- Failure to perform reconciliations of significant accounts. For example, accounts receivable subsidiary ledgers are not reconciled to the general ledger account in a timely or accurate manner.
- Undue bias or lack of objectivity by those responsible for accounting decisions (for example, consistent understatement of expenses or overstatement of allowances at the direction of management).
- Misrepresentation by entity personnel to the auditor (an indicator of fraud).

- Management override of controls.
- Failure of an application control caused by a deficiency in the design or operation of an IT general control.
- An observed deviation rate that exceeds the number of deviations expected by the auditor in a test of the operating effectiveness of a control. For example, if the auditor designs a test in which he or she selects a sample and expects no deviations, the finding of one deviation is a nonnegligible deviation rate because based on the results of the auditor's test of the sample, the desired level of confidence was not obtained.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Exhibit A — Illustrative Auditor's Written Communication

.A39 The following is an illustrative auditor's written communication encompassing the requirements in paragraph .14.

To Management and [*identify the body or individuals charged with governance, such as the entity's Board of Directors*] of ABC Company

In planning and performing our audit of the financial statements of ABC Company (the "Company") as of and for the year ended December 31, 20XX, in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) 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 Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be [*material weaknesses* or *material weaknesses or significant deficiencies*] and therefore, [*material weaknesses* or *material weaknesses or significant deficiencies*] may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be [*material weaknesses* or *significant deficiencies* or *material weaknesses and significant deficiencies*].

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, 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. [*We consider the following deficiencies in the Company's internal control to be material weaknesses:*]

[*Describe the material weaknesses that were identified and an explanation of their potential effects.*]

[*A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Company's internal control to be significant deficiencies:*]

[*Describe the significant deficiencies that were identified and an explanation of their potential effects.*]

[*If the auditor is communicating significant deficiencies and did not identify any material weaknesses, the auditor may state that none of the identified significant deficiencies are considered to be material weaknesses.*]

This communication is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, and [*identify any governmental authorities to which the auditor is required to report*] and is not intended to be, and should not be, used by anyone other than these specified parties.[1]

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date*]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

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[1]When the engagement is also performed in accordance with *Government Auditing Standards*, the alert required by paragraph .14*d* may read as follows: "The purpose of this communication is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide Government Auditing Standards *and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Exhibit B — Illustrative No Material Weakness Communication

.A40 The following is an illustrative auditor's written communication indicating that no material weaknesses were identified during the audit of a not-for-profit organization.

To Management and [*identify the body or individuals charged with governance, such as the entity's Board of Directors*] of NPO Organization

In planning and performing our audit of the financial statements of NPO Organization (the "Organization") as of and for the year ended December 31, 20XX, in accordance with auditing standards generally accepted in the United States of America, we considered the Organization's internal control over financial reporting (internal control) 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 Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

[*If one or more significant deficiencies have been identified, the auditor may add the following: Our audit was also not designed to identify deficiencies in internal control that might be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We communicated the significant deficiencies identified during our audit in a separate communication dated [date].*]

This communication is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, and [*identify any governmental authorities to which the auditor is required to report*] and is not intended to be, and should not be, used by anyone other than these specified parties.[1]

[*Auditor's signature*]

[1]When the engagement is also performed in accordance with *Government Auditing Standards*, the alert required by paragraph .14*d* may read as follows: "The purpose of this communication is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide Government Auditing Standards *and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

[*Auditor's city and state*]

[*Date*]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

AU-C Section 9265

Communicating Internal Control Related Matters Identified in an Audit: Auditing Interpretations of Section 265

1. Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Participants in Office of Management and Budget Single Audit Pilot Project

.01 *Question*—On October 7, 2009, the Office of Management and Budget (OMB) published the parameters of a pilot project, which is a collaborative effort between volunteer nonfederal entities expending American Recovery and Reinvestment Act of 2009 (ARRA) awards (auditees), the auditors performing compliance audits of auditees with ARRA expenditures under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the federal government. For auditees that volunteer, the pilot project requires their auditors to issue to management an early written communication of significant deficiencies and material weaknesses in internal control over compliance at an interim date, prior to the completion of the compliance audit. Such communication would be based on internal control work performed on specified compliance requirements for two major programs with ARRA expenditures chosen from a list of approved ARRA pilot project programs. This communication also would be required to be submitted by management to the cognizant agency for audit. May an auditor issue such an interim communication in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*?

.02 *Interpretation*—Yes. Section 265 permits an auditor to communicate to management identified significant deficiencies and material weaknesses before the completion of a financial statement audit. It would be equally appropriate for a compliance audit. Regardless of how the early communication is delivered, the auditor should communicate all significant deficiencies and material weaknesses in writing to management and those charged with governance in accordance with section 265.[1]

.03 The following is an illustrative communication that an auditor may use to comply with the pilot project communication requirement to inform management and those charged with governance of deficiencies in internal control over compliance related to ARRA funding that have been identified at an interim date prior to the completion of the compliance

[1]Paragraphs .11–.13 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

audit and are, or likely to be, in the auditor's judgment, significant deficiencies or material weaknesses in internal control over compliance:

This communication is provided pursuant to the parameters of the 2009 Office of Management and Budget (OMB) pilot project. Such project requires auditors of entities that volunteer for the project to issue, in writing, an early communication of significant deficiencies and material weaknesses in internal control over compliance for certain federal programs having expenditures of American Recovery and Reinvestment Act of 2009 (ARRA) funding at an interim date, prior to the completion of the compliance audit. Accordingly, this communication is based on our audit procedures performed through [insert "as of date"], an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through [insert "as of date"] of [identify the federal programs selected to be tested as a major program from the federal list of approved ARRA pilot project programs], we are considering [Example Entity's] compliance with [list the applicable types of compliance requirements subject to the communication requirement in the pilot project (for example, activities allowed or unallowed, allowable costs and cost principles, cash management, eligibility, reporting, and special tests and provisions)] as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 2009. We are also considering [Example Entity's] internal control over compliance with the requirements previously described that could have a direct and material effect on [identify the federal programs selected to be tested as a major program from the federal list of approved ARRA pilot project programs] in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the [Example Entity's] internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed through [insert "as of date"], we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A *deficiency in internal control* over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement[2] of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or a combination of deficiencies,

[2]Under Section 510(a)(1) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the auditor's determination of whether a deficiency in internal control over compliance is a material weakness or significant deficiency for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified

in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in internal control over compliance to be material weaknesses:

[Describe the material weaknesses that were identified either here or by reference to a separate schedule.][3]

A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control over compliance to be significant deficiencies:

[Describe the significant deficiencies that were identified either here or by reference to a separate schedule.][4]

[Example Entity's] responses to our findings are described [insert either "in the preceding paragraph" or "in the accompanying schedule"]. We did not audit [Example Entity's] responses and, accordingly, we express no opinion on the responses.[5]

This interim communication is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, [identify the legislative or regulatory body], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: November 1994; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

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in the *OMB Circular A-133 Compliance Supplement* (the *Compliance Supplement*). This reference to "type of compliance requirement" refers to the 14 types of compliance requirements (identified as A-N) described in part 3 of the *Compliance Supplement*. For purposes of reporting audit findings, auditors are alerted that certain of the types of compliance requirements may include multiple compliance requirements with multiple audit objectives (for example, compliance requirement "G" covers 3 separate requirements—matching, level of effort, and earmarking; and "N" covers separate requirements specific to each individual special test and provision).

[3]The OMB pilot project requires the auditee, upon receipt of the interim communication from the auditor, to provide it to the federal cognizant agency for audit. Federal agencies are required to follow-up with the auditee concerning actions taken or needed to correct the finding. Therefore, to assist the federal agencies with this responsibility, significant deficiency and material weakness finding descriptions should include the level of detail required by both *Government Auditing Standards* and Section 510(b) of OMB Circular A-133. This would require the inclusion of, among other things, the views of responsible officials (see footnote 5).

[4]See footnote 3.

[5]The OMB pilot project requires the auditor to obtain management responses to the internal control matters identified and to include them in the interim communication.

2. Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Auditors That Are Not Participants in Office of Management and Budget Pilot Project

.04 *Question*—Part 6, "Internal Control," of the *OMB Circular A-133 Compliance Supplement* (the *Compliance Supplement*) stresses the importance of internal control testwork over major programs with ARRA expenditures and encourages early communication to management and those charged with governance of any significant deficiencies or material weaknesses in internal control:

> Early communication by auditors to management, and those charged with governance, of identified control deficiencies related to ARRA funding that are, or likely to be, significant deficiencies or material weaknesses in internal control will allow management to expedite corrective action and mitigate the risk of improper expenditure of ARRA awards. Therefore, auditors are encouraged to promptly inform auditee management and those charged with governance during the audit engagement about control deficiencies related to ARRA funding that are, or likely to be, significant deficiencies or material weaknesses in internal control. The auditor should use professional judgment regarding the form of such interim communications.

.05 Although not required, if an auditor decides to make such a communication in writing at an interim date, may the auditor issue the interim communication in accordance with section 265?

.06 *Interpretation*—Yes. As noted in the previous question, section 265 permits an auditor to communicate to management and those charged with governance identified significant deficiencies and material weaknesses before the completion of a financial statement audit. It would be equally appropriate for a compliance audit. The auditor is reminded that, regardless of how the early communication is delivered, the auditor should communicate all significant deficiencies and material weaknesses in writing to management and those charged with governance in accordance with section 265.[6]

.07 If the auditor decides to make the interim communication encouraged in part 6 of the *Compliance Supplement* in writing, the following is an illustrative communication that an auditor may use to inform management and those charged with governance of deficiencies in internal control over compliance related to ARRA funding that have been identified at an interim date prior to the completion of the compliance audit and that are, or likely to be, in the auditor's judgment, significant deficiencies or material weaknesses in internal control:

[6]See footnote 1.

This communication is provided pursuant to the *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement*, which encourages auditors to communicate, at an interim date, control deficiencies related to federal programs with expenditures of American Recovery and Reinvestment Act of 2009 (ARRA) funding that are, or likely to be, significant deficiencies or material weaknesses in internal control over compliance. Accordingly, this communication is based on our audit procedures performed through [insert "as of date"], an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through [insert "as of date"] of [identify the federal programs with ARRA expenditures selected by the auditor to be tested as a major program], we are considering [Example Entity's] compliance with the applicable types of compliance requirements as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 20XX. We are also considering [Example Entity's] internal control over compliance with the requirements previously described that could have a direct and material effect on [identify the federal programs with ARRA expenditures selected by the auditor to be tested as a major program] in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the [Example Entity's] internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed through [insert "as of date"], we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A *deficiency in internal control* over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement[7] of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in internal control over compliance to be material weaknesses:

[7]See footnote 2.

[Describe the material weaknesses that were identified either here or by reference to a separate schedule.]

A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control over compliance to be significant deficiencies:

[Describe the significant deficiencies that were identified either here or by reference to a separate schedule.]

This interim communication is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, [identify the legislative or regulatory body], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: November 2009; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

3. Appropriateness of Identifying No Significant Deficiencies or No Material Weaknesses in an Interim Communication

.08 *Question*—In either of the previously described scenarios, may the auditor issue an interim communication in accordance with section 265 stating that as of the interim communication date, no significant deficiencies or material weaknesses have been noted?

.09 *Interpretation*—No. Section 265 states that the auditor should not issue a written communication stating that no significant deficiencies were identified during the audit.[8] Such guidance would also apply to the interim communication contemplated in the previous two questions. Therefore, it would not be appropriate for an auditor to issue an interim communication stating that no significant deficiencies were identified.

.10 Although section 265 would permit the auditor to issue a communication at the end of an audit stating that no material weaknesses were identified by the auditor, it would not be appropriate for an auditor to do so at an interim date.[9] Making such a communication at an interim date could lead to misinterpretation by management and those charged with governance, that there are no identified material weaknesses when, in fact, material weaknesses could be identified before completion of the compliance audit.

[8] Paragraph .16 of section 265.

[9] Paragraph .15 of section 265.

[Issue Date: November 2009; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

AU-C Sections 300–499

RISK ASSESSMENT AND RESPONSE TO ASSESSED RISKS

AU-C Section 300

Planning an Audit

Source: SAS No. 122; SAS No. 128; SAS No. 134; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to plan an audit of financial statements. This section is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified in this section. Matters related to planning audits of group financial statements are addressed in section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. (Ref: par. .A1–.A3)

The Role and Timing of Planning

.02 Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit
- Helping the auditor identify and resolve potential problems on a timely basis
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

Effective Date

.03 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.04 The objective of the auditor is to plan the audit so that it will be performed in an effective manner.

Requirements

Involvement of Key Engagement Team Members

.05 The engagement partner and other key members of the engagement team should be involved in planning the audit, including planning and participating in the discussion among engagement team members. (Ref: par. .A4–.A5)

Preliminary Engagement Activities

.06 The auditor should undertake the following activities at the beginning of the current audit engagement:

a. Performing procedures required by section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, regarding the continuance of the client relationship and the specific audit engagement

b. Evaluating compliance with relevant ethical requirements in accordance with section 220A

c. Establishing an understanding of the terms of the engagement as required by section 210A, *Terms of Engagement* (Ref: par. .A6–.A8)

Planning Activities

.07 The auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit and that guides the development of the audit plan.

.08 In establishing the overall audit strategy, the auditor should

a. identify the characteristics of the engagement that define its scope;

b. ascertain the reporting objectives of the engagement in order to plan the timing of the audit and the nature of the communications required;

c. consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;

d. consider the results of preliminary engagement activities and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and

e. ascertain the nature, timing, and extent of resources necessary to perform the engagement. (Ref: par. .A9–.A13)

.09 The auditor should develop an audit plan that includes a description of the following:

a. The nature and extent of planned risk assessment procedures, as determined under section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

b. The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

c. Other planned audit procedures that are required to be carried out so that the engagement complies with generally accepted auditing standards (Ref: par. .A14–.A16)

.10 The auditor should update and change the overall audit strategy and audit plan, as necessary, during the course of the audit. (Ref: par. .A17)

.11 The auditor should plan the nature, timing, and extent of direction and supervision of engagement team members and the review of their work. (Ref: par. .A18–.A19)

Determining the Extent of Involvement of Professionals Possessing Specialized Skills

.12 The auditor should consider whether specialized skills are needed in performing the audit. If specialized skills are needed, the auditor should seek the assistance of a professional possessing such skills, who either may be on the auditor's staff or an outside professional.[1] In such circumstances, the auditor should have sufficient knowledge to communicate the objectives of the other professional's work; evaluate whether the specified audit procedures will meet the auditor's objectives; and evaluate the results of the audit procedures applied as they relate to the nature, timing, and extent of further planned audit procedures. Section 620, *Using the Work of an Auditor's Specialist*, addresses the auditor's use of the work of specialists in an audit. (Ref: par. .A20–.A21)

Additional Considerations in Initial Audit Engagements

.13 The auditor should undertake the following activities prior to starting an initial audit:

a. Performing procedures required by section 220A

b. Communicating with the predecessor auditor when there has been a change of auditors, in accordance with section 210A[2] (Ref: par. .A22)

Documentation

.14 The auditor should include in the audit documentation the following:[3]

a. The overall audit strategy

b. The audit plan

c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan and the reasons for such changes (Ref: par. .A23–.A26)

Application and Other Explanatory Material

The Role and Timing of Planning (Ref: par. .01)

.A1 The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement.

.A2 Planning is not a discrete phase of an audit but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit

[1]Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .11 of section 210A, *Terms of Engagement*.

[3]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as the following:

- The analytical procedures to be applied as risk assessment procedures
- A general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework
- The determination of materiality
- The involvement of specialists
- The performance of other risk assessment procedures

.A3 The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

Involvement of Key Engagement Team Members (Ref: par. .05)

.A4 The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The engagement partner may delegate portions of the planning and supervision of the audit to other firm personnel.

.A5 Section 315A requires a discussion among the audit team about the susceptibility of the entity's financial statements to material misstatement.[4] This discussion also may include the discussion regarding the risks of material misstatement due to fraud, as required by section 240, *Consideration of Fraud in a Financial Statement Audit*.[5] The objective of this discussion is for members of the audit team to gain a better understanding of the potential for material misstatements of the financial statements resulting from fraud or error in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures.

[4]Paragraph .11 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[5]Paragraph .15 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

Preliminary Engagement Activities (Ref: par. .06)

.A6 Performing the preliminary engagement activities, which are specified in paragraph .06, at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.

.A7 Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example

- the auditor maintains the necessary independence and ability to perform the engagement.
- the auditor has no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- the auditor has no misunderstanding with the entity about the terms of the engagement.

.A8 The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: par. .07–.08)

.A9 The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as the following:

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of specialists on complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed, and supervised, such as when team briefing and debriefing meetings are expected to be held, how the engagement partner

and manager reviews are expected to take place (for example, on site or off site), and whether to complete engagement quality control reviews

.A10 The appendix, "Considerations in Establishing the Overall Audit Strategy," lists examples of considerations in establishing the overall audit strategy.

.A11 Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes but are closely interrelated because changes in one may result in consequential changes to the other.

Considerations Specific to Smaller, Less Complex Entities

.A12 In audits of smaller entities, the entire audit may be conducted by a very small audit team. Many audits of smaller entities involve the engagement partner (who may be a sole practitioner) working with one engagement team member (or without any engagement team members). With a smaller team, coordination of, and communication between, team members is easier. Establishing the overall audit strategy for the audit of a smaller entity need not be a complex or time consuming exercise; it varies according to the size and complexity of the entity, the complexity of the audit, and the size of the engagement team. For example, a brief memorandum prepared at the completion of the previous audit, based on a review of the working papers and highlighting issues identified in the audit just completed, updated in the current period, based on discussions with the owner-manager, can serve as the documented audit strategy for the current audit engagement if it covers the matters noted in paragraph .07.

Communications With Those Charged With Governance

.A13 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit.[6]

The Audit Plan (Ref: par. .09)

.A14 The audit plan is more detailed than the overall audit strategy in that it includes the nature, timing, and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing, and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances, and disclosures before planning all remaining further audit procedures.

[6] Paragraph .11 of section 260, *The Auditor's Communication With Those Charged With Governance*.

.A15 Determining the nature, timing, and extent of planned risk assessment procedures, and further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing, and extent of audit procedures to address them. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A16 Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events, and account balances are addressed. Early consideration may also help the auditor to determine the effects on the audit of the following:

- Significant new or revised disclosures required as a result of changes in the entity's environment, financial condition, or activities (for example, disclosures about discontinued operations or a significant business combination)
- Significant new or revised disclosures arising from changes in the applicable financial reporting framework
- The need for the involvement of an auditor's expert to assist with audit procedures related to particular disclosures (for example, disclosures related to pension or other retirement benefit obligations)
- Matters relating to disclosures that the auditor may wish to discuss with those charged with governance[7]

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Changes to Planning Decisions During the Course of the Audit (Ref: par. .10)

.A17 As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and, thereby, the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Direction, Supervision, and Review (Ref: par. .11)

.A18 The nature, timing, and extent of the direction and supervision of engagement team members and review of their work vary, depending on many factors, including the following:

[7] Paragraph .A13 of section 260. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- The size and complexity of the entity
- The area of the audit
- The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members and a more detailed review of their work)
- The capabilities and competence of the individual team members performing the audit work

Section 220A contains further guidance on the direction, supervision, and review of audit work. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A19 If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor's professional body. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Determining the Extent of Involvement of Professionals Possessing Specialized Skills (Ref: par. .12)

.A20 An auditor may decide to seek the assistance of a professional with specialized skills necessary to complete various aspects of the engagement. These professionals may include valuation experts, appraisers, actuaries, tax specialists, and IT professionals. For example, the use of professionals possessing IT skills to determine the effect of IT on the audit, understand the IT controls, or design and perform tests of IT controls or substantive procedures is a significant aspect of many audit engagements. In determining whether such a professional is needed on the audit team, the auditor may consider such factors as the following:

- The complexity of the entity's systems and IT controls and the manner in which they are used in conducting the entity's business
- The significance of changes made to existing systems or the implementation of new systems
- The extent to which data is shared among systems
- The extent of the entity's participation in electronic commerce
- The entity's use of emerging technologies

- The significance of audit evidence that is available only in electronic form

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A21 Audit procedures that the auditor may assign to a professional possessing IT skills include inquiring of an entity's IT personnel how data and transactions are initiated, authorized, recorded, processed, and reported and how IT controls are designed; inspecting systems documentation; observing the operation of IT controls; and planning and performing tests of IT controls. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Additional Considerations in Initial Audit Engagements (Ref: par. .13)

.A22 The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Arrangements to be made with the predecessor auditor (for example, to review the predecessor auditor's working papers [see section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*])[8]
- Any major issues (including the application of accounting principles or auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance, and how these matters affect the overall audit strategy and audit plan
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (see section 510)[9]
- Other procedures required by the firm's system of quality control for initial audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .14)

.A23 The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and communicate significant issues to the engagement team. For example, the auditor may summarize the overall audit strategy in

[8] Paragraphs .07 and .A2–.A11 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[9] Paragraph .08 of section 510. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

the form of a memorandum that contains key decisions regarding the overall scope, timing, and conduct of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A24 The documentation of the audit plan is a record of the planned nature, timing, and extent of risk assessment procedures and further audit procedures at the relevant assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs or audit completion checklists, tailored as needed to reflect the particular engagement circumstances. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A25 A record of the significant changes to the overall audit strategy and the audit plan and resulting changes to the planned nature, timing, and extent of audit procedures explain why the significant changes were made and why the overall strategy and audit plan were finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A26 As discussed in paragraph .A12, a suitable, brief memorandum may serve as the documented strategy for the audit of a smaller entity. For the audit plan, standard audit programs or checklists (see paragraph .A24) drawn up on the assumption of few controls, which is likely to be the case in a smaller entity, may be used, provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Appendix — Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)

.A27

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters also will influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

Characteristics of the Engagement

The following are some examples of characteristics of the engagement:

- The financial reporting framework on which the financial information to be audited has been prepared, including any need for reconciliations to another financial reporting framework
- Industry specific reporting requirements, such as reports mandated by industry regulators
- The expected audit coverage, including the number and locations of components to be included
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated
- The extent to which components are audited by other auditors
- The nature of the business divisions to be audited, including the need for specialized knowledge
- The reporting currency to be used, including any need for currency translation for the audited financial information
- The need for statutory or regulatory audit requirements (for example, the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*)
- Whether the entity has an internal audit function and, if so, whether (in which areas and to what extent) the work of the internal audit function can be used in obtaining audit evidence or whether internal auditors can be used to provide direct assistance
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them
- The expected use of audit evidence obtained in previous audits (for example, audit evidence related to risk assessment procedures and tests of controls)

- The effect of IT on the audit procedures, including the availability of data and the expected use of computer assisted audit techniques
- The coordination of the expected coverage and timing of the audit work with any reviews of interim financial information and the effect on the audit of the information obtained during such reviews
- The availability of client personnel and data

Reporting Objectives, Timing of the Audit, and Nature of Communications

The following examples illustrate reporting objectives, timing of the audit, and nature of communications:

- The entity's timetable for reporting, including interim periods
- The organization of meetings with management and those charged with governance to discuss the nature, timing, and extent of the audit work
- The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters, and communications to those charged with governance
- The discussion with management regarding the expected communications on the status of audit work throughout the engagement
- Communication with auditors of components regarding the expected types and timing of reports to be issued and other communications in connection with the audit of components
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
  - — The determination of materiality for components and communication thereof to component auditors in accordance with section 600A, *Special Considerations —Audits of Group Financial Statements (Including the Work of Component Auditors)*

  - — The preliminary identification of significant components and material classes of transactions, account balances, and disclosures

- Preliminary identification of areas in which there may be a higher risk of material misstatement
- The effect of the assessed risk of material misstatement at the overall financial statement level on direction, supervision, and review
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and exercise professional skepticism in gathering and evaluating audit evidence
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity
- Evidence of management's commitment to the design, implementation, and maintenance of sound internal control, including evidence of appropriate documentation of such internal control
- Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control
- Importance attached to internal control throughout the entity to the successful operation of the business
- The processes management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers
- Significant business developments affecting the entity, including changes in IT and business processes; changes in key management; and acquisitions, mergers, and divestments
- Significant industry developments, such as changes in industry regulations and new reporting requirements
- Other significant relevant developments, such as changes in the legal environment affecting the entity

Nature, Timing, and Extent of Resources

The following examples illustrate the nature, timing, and extent of resources:

- The selection of the engagement team (including, when necessary, the engagement quality control reviewer [see section 220A, *Quality Control for an Engagement*

Conducted in Accordance With Generally Accepted Auditing Standards]) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas in which there may be higher risks of material misstatement

- Engagement budgeting, including considering the appropriate amount of time to set aside for areas in which there may be higher risks of material misstatement

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

AU-C Section 315

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

(Supersedes SAS No. 122 section 315)

Source: SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2023.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements.

Key Concepts in This Section

.02 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, addresses the overall objectives of the auditor in conducting an audit of the financial statements, including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.[1] Audit risk is a function of the risks of material misstatement and detection risk.[2]Section 200 explains that the risks of material misstatement may exist at two levels:[3]

the overall financial statement level and the assertion level for classes of transactions, account balances, and disclosures.

.03 Section 200 requires the auditor to exercise professional judgment in planning and performing an audit and to plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated.[4]

.04 Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components:[5] inherent risk and control risk.

- *Inherent risk* is described as the susceptibility of an assertion about a class of transactions, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- *Control risk* is described as the risk that a misstatement that could occur in an assertion about a class of transactions, account balance, or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.

.05 Section 200 explains that risks of material misstatement are assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. For purposes of generally accepted auditing standards (GAAS), a risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).[6] For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by this section. As explained in section 200, inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. The degree to which the level of inherent risk varies is referred to in this section as the *spectrum of inherent risk*.

.06 Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this section, the significance of fraud is such that further requirements and guidance are included in section 240, *Consideration of Fraud in a Financial Statement Audit*, in relation to risk assessment

[1]Paragraph .19 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .14 of section 200.

[3]Paragraph .A38 of section 200.

[4]Paragraphs .17–.18 of section 200.

[5]Paragraph .14 of section 200.

[6]Paragraphs .A41–.A43 of section 200 and paragraph .07 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

procedures and related activities to obtain information that is used to identify, assess, and respond to the risks of material misstatement due to fraud.

.07 The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. In obtaining the understanding required by this section, initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process. In addition, paragraph .41 of this section and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*,[7] require the auditor to revise the risk assessments and modify further overall responses and further audit procedures, based on audit evidence obtained from performing further audit procedures in accordance with section 330, or if new information is obtained.

.08 Section 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.[8]Section 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. Section 330 also requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the relevant assertion level.[9]

Scalability

.09 Section 200 states that some AU-C sections include scalability considerations, which illustrate the application of the requirements to all entities, regardless of whether their nature and circumstances are less complex or more complex.[10] This section is intended for audits of all entities, regardless of size or complexity; therefore, the application material incorporates considerations specific to both less and more complex entities, where appropriate. Although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex.

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2023.

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[7]Paragraph .27 of section 330.

[8]Paragraph .05 of section 330.

[9]Paragraph .06 of section 330.

[10]Paragraph .A68 of section 200.

Objective

.11 The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Definitions

.12 For purposes of GAAS, the following terms have the meanings attributed:

Assertions. Representations, explicit or otherwise, with respect to the recognition, measurement, presentation, and disclosure of information in the financial statements, which are inherent in management, representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing, and responding to the risks of material misstatement. (Ref: par. .A1)

Business risk. A risk resulting from significant conditions, events, circumstances, actions, or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

Controls. Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance. In this context (Ref: par. .A2–.A5)

i. policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.

ii. procedures are actions to implement policies.

General information technology (IT) controls. Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity's information system. Also see **IT environment**. (Ref: par. A6)

Information-processing controls. Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information. (Ref: par. .A7–.A8)

Inherent risk factors. Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors[11] insofar as they affect inherent risk.

Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as *the spectrum of inherent risk*. (Ref: par. .A9–.A11, .A238–.A244)

IT environment. The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this definition

i. an *IT application* is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.

ii. the IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.

iii. the IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment, and manage IT operations.

Relevant assertions. An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement. A risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).[12] The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (that is, the determination is based on inherent risk). (Ref: par. .A12)

Risks arising from the use of IT. Susceptibility of information-processing controls to ineffective design or operation, or risks to the integrity of information in the entity's information system, due to ineffective design or operation of controls in the entity's IT processes. See **IT environment**. (Ref: par. .A6 and .A13)

Risk assessment procedures. The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Significant class of transactions, account balance, or disclosure. A class of transactions, account balance, or disclosure for which there is one or more relevant assertions. (Ref: par. .A14)

Significant risk. An identified risk of material misstatement (Ref: par. .A15)

i. for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination

[11] Paragraphs .A28–.A32 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

[12] Paragraphs .A41–.A43 of section 200 and paragraph .07 of section 330.

of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or

ii. that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.[13]

System of internal control. The system designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For purposes of GAAS, the system of internal control consists of five interrelated components:

i. Control environment

ii. The entity's risk assessment process

iii. The entity's process to monitor the system of internal control

iv. The information system and communication

v. Control activities

(Ref: par. .A16)

Requirements

Risk Assessment Procedures and Related Activities

.13 The auditor should design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for (Ref: par. .A17–.A24)

a. the identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, and

b. the design of further audit procedures in accordance with section 330.

The auditor should design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.

.14 The risk assessment procedures should include the following: (Ref: par. .A25–.A27)

a. Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) (Ref: par. .A28–.A32)

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[13]Paragraph .27 of section 240 and paragraph .20 of section 550, *Related Parties*.

b. Analytical procedures (Ref: par. .A33–.A37)

c. Observation and inspection (Ref: par. .A38–.A42)

Information From Other Sources

.15 In obtaining audit evidence in accordance with paragraph .13, the auditor should consider information from (Ref: par. .A43–.A44)

a. the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and

b. when applicable, other engagements performed by the engagement partner for the entity.

.16 When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: par. .A45–.A47)

Engagement Team Discussion

.17 The engagement partner and other key engagement team members should discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement. (Ref: par. .A48–.A54)

.18 When there are engagement team members not involved in the engagement team discussion, the engagement partner should determine which matters are to be communicated to those members.

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: par. .A55–.A57)

Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework (Ref: par. .A58–.A63)

.19 The auditor should perform risk assessment procedures to obtain an understanding of

a. the following aspects of the entity and its environment:

   i. The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT (Ref: par. .A64–.A77)

   ii. Industry, regulatory, and other external factors (Ref: par. .A78–.A82)

   iii. The measures used, internally and externally, to assess the entity's financial performance (Ref: par. .A83–.A90)

b. the applicable financial reporting framework and the entity's accounting policies and the reasons for any changes thereto. (Ref: par. .A91–.A93)

c. how inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework, based on the understanding obtained in subparagraphs *a*–*b*. (Ref: par. .A94–.A99)

.20 The auditor should evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

Understanding the Components of the Entity's System of Internal Control (Ref: par. .A100–.A111)

Control Environment, the Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control (Ref: par. .A112–.A114)

Control Environment

.21 The auditor should, through performing risk assessment procedures, obtain an understanding of the control environment relevant to the preparation of the financial statements by (Ref: par. .A115–.A116)

a. understanding the set of controls, processes, and structures that address (Ref: par. .A117)

   i. how management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values;

   ii. when those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;

   iii. the entity's assignment of authority and responsibility;

   iv. how the entity attracts, develops, and retains competent individuals;

   v. how the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; and

b. evaluating, based on the auditor's understanding obtained in paragraph .21*a*, whether (Ref: par. .A118–.A123)

   i. management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;

   ii. the control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and

iii. control deficiencies identified in the control environment undermine the other components of the entity's system of internal control

The Entity's Risk Assessment Process

.22 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements by

a. understanding the entity's process for (Ref: par. .A124–.A126)

   i. identifying business risks, including the potential for fraud, relevant to financial reporting objectives; (Ref: par. .A71)

   ii. assessing the significance of those risks, including the likelihood of their occurrence;

   iii. addressing those risks; and

b. evaluating, based on the auditor's understanding obtained in paragraph .22*a*, whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: par. .A127–.A129)

.23 If the auditor identifies risks of material misstatement that management failed to identify, the auditor should

a. determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement; and

b. consider the implications for the auditor's evaluation in paragraph .22*b*.

The Entity's Process for Monitoring the System of Internal Control

.24 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements by (Ref: par. .A130–.A131)

a. understanding those aspects of the entity's process that address

   i. ongoing and separate evaluations for monitoring the effectiveness of controls and the identification and remediation of control deficiencies identified (Ref: par. .A132–.A133) and

   ii. the entity's internal audit function, if any, including its nature, responsibilities, and activities (Ref: par. .A134–.A135).

b. understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose (Ref: par. .A136–.A137).

c. evaluating, based on the auditor's understanding obtained in paragraph .24*a*–*b*, whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity (Ref: par. .A138–.A139).

Information System and Communication, and Control Activities (Ref: par. .A140–.A147)

<u>The Information System and Communication</u>

.25 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements by (Ref: par. .A148–.A149)

a. understanding the entity's information-processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances, and disclosures (Ref: par. .A150–.A162)

    i. how information flows through the entity's information system, including how

        1. transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements and

        2. information about events and conditions, other than transactions, is captured, processed, and disclosed in the financial statements,

    ii. the accounting records, specific accounts in the financial statements, and other supporting records relating to the flows of information in the information system,

    iii. the financial reporting process used to prepare the entity's financial statements, including disclosures, and

    iv. the entity's resources, including the IT environment, relevant to preceding *a*(i)–(iii).

b. *b*. understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control (Ref: par. .A163–.A164)

    i. between people within the entity, including how financial reporting roles and responsibilities are communicated,

    ii. between management and those charged with governance,

iii. with external parties, such as those with regulatory authorities.

c. evaluating, based on the auditor's understanding obtained in paragraph .25*a*–*b*, whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework considering the nature and complexity of the entity. (Ref: par. .A165).

Control Activities

.26 The auditor should, through performing risk assessment procedures, obtain an understanding of the control activities component, by applying the requirements in paragraphs .27–.30. (Ref: par. .A167–.A179)

.27 The auditor should identify the following controls that address risks of material misstatement at the assertion level:

a. Controls that address a risk that is determined to be a significant risk (Ref: par. .A180–.A181)

b. Controls over journal entries and other adjustments as required by section 240[14] (Ref: par. .A182–.A183)

c. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which should include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence (Ref: par. .A184–.A186)

d. Other controls that, based on the auditor's professional judgment, the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph .13 with respect to risks at the assertion level (Ref: par. .A187–.A188)

.28 Based on controls identified in paragraph .27, the auditor should identify the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT.

.29 For the IT applications and other aspects of the IT environment identified in paragraph .28, the auditor should identify the following: (Ref: par. .A189–.A200)

a. The related risks arising from the use of IT

b. The entity's general IT controls that address such risks

.30 For each control identified in paragraph .27 or .29*b*, the auditor should (Ref: par. .A201–.A210)

[14]Paragraph 32*a*(i) of section 240.

a. evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level or effectively designed to support the operation of other controls.

b. determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.

Control Deficiencies Within the Entity's System of Internal Control

.31 Based on the auditor's understanding and evaluation of the components of the entity's system of internal control as required by this section, the auditor should determine whether one or more control deficiencies have been identified. (Ref: par. .A211–.A212)

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .A213–.A214)

Identifying Risks of Material Misstatement

.32 The auditor should identify the risks of material misstatement and determine whether they exist at (Ref: par. .A215–.A221)

a. the financial statement level (Ref: par. .A222–.A229) or

b. the assertion level for classes of transactions, account balances, and disclosures (Ref: par. .A230–.A231).

.33 The auditor should determine the relevant assertions and the related significant classes of transactions, account balances, and disclosures. (Ref: par. .A232–.A234)

Assessing Risks of Material Misstatement at the Financial Statement Level

.34 For identified risks of material misstatement at the financial statement level, the auditor should assess the risks and (Ref: par. .A222–.A229)

a. determine whether such risks affect the assessment of risks at the assertion level, and

b. evaluate the nature and extent of their pervasive effect on the financial statements.

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: par. .A235–.A244)

.35 For identified risks of material misstatement at the assertion level, the auditor should assess inherent risk by assessing the likelihood and magnitude of misstatement. In doing so, the auditor should take into account how, and the degree to which

a. inherent risk factors affect the susceptibility of relevant assertions to misstatement, and

b. the risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level. (Ref: par. .A245–.A246)

.36 The auditor should determine whether any of the assessed risks of material misstatement are significant risks. (Ref: par. .A247–.A251)

.37 The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level. (Ref: par. .A252–.A255)

Assessing Control Risk

.38 For identified risks of material misstatement at the assertion level, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: par. .A256–.A260)

Evaluating the Audit Evidence Obtained From the Risk Assessment Procedures

.39 The auditor should evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor should perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor should take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: par. .A261–.A263)

Classes of Transactions, Account Balances, and Disclosures That Are Not Significant but Are Material

.40 For material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account balances, or disclosures, the auditor should evaluate whether the auditor's determination remains appropriate. (Ref: par. .A264–.A265)

Revision of Risk Assessment

.41 If the auditor obtains new information that is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor should revise the identification or assessment. (Ref: par. .A266)

Documentation

.42 The auditor should include in the audit documentation[15] (Ref: par. .A267–.A273)

a. the discussion among the engagement team in accordance with paragraphs .17–.18 and the significant decisions reached;

b. key elements of the auditor's understanding in accordance with paragraphs .19, .21–.22, and .24–.25; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;

c. the evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with paragraph .30; and

d. the identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.

Application and Other Explanatory Material

Definitions (Ref: par. .12)

Assertions

.A1 Categories of assertions are used by auditors to consider the different types of potential misstatements that may occur when identifying, assessing, and responding to the risks of material misstatement. Examples of these categories of assertions are described in paragraph .A219. The assertions differ from the written representations required by section 580, *Written Representations*, to confirm certain matters or support other audit evidence.

Controls

.A2 Controls are embedded within the components of the entity's system of internal control.

.A3 Policies are implemented through the actions of personnel within the entity or through the restraint of personnel from taking actions that would conflict with such policies.

.A4 Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviors that are not mandated but, rather, are conditioned by the entity's culture. Procedures may be enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.

.A5 Controls may be direct or indirect (see paragraphs .A112, .A140, and .A168). *Direct controls* are controls that are precise enough to address risks of material misstatement at the assertion level. *Indirect controls* are controls that support direct controls. Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis.

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[15] Paragraphs .08–.12 and .A8–.A9 of section 230, *Audit Documentation*.

General IT Controls

.A6 The integrity of information may include the completeness, accuracy, and validity of transactions and other information. Although this section does not prescribe the use of a particular internal control framework, the auditor may find the following guidance regarding the concepts encompassed by the term *validity*, from COSO's 2013 *Internal Control — Integrated Framework* (COSO framework), helpful: "Recorded transactions represent economic events that actually occurred and were executed according to prescribed procedures. Validity is generally achieved through control activities that include the authorization of transactions as specified by an organization's established policies and procedures (that is, approval by a person having the authority to do so)."[16] The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book) provides similar guidance on validity.[17]

Information-Processing Controls

.A7 Risks to the integrity of information arise from susceptibility to ineffective implementation of the entity's information policies, which are policies that define the information flows, records, and reporting processes in the entity's information system. Information-processing controls are procedures that support effective implementation of the entity's information policies. Information-processing controls may be automated (that is, embedded in IT applications) or manual (for example, input or output controls) and may rely on other controls, including other information-processing controls or general IT controls.

.A8 Business processes result in the transactions that are recorded, processed, and reported by the information system. Information-processing controls are also known as *transaction controls*. Such controls directly support the actions to mitigate information-processing risks in an entity's business processes.

Inherent Risk Factors

.A9 Appendix B, "Understanding Inherent Risk Factors," sets out further considerations relating to understanding inherent risk factors.

.A10 Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include the following:

- Complexity
- Subjectivity
- Change
- Uncertainty

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[16] Section 7, "Control Activities" of COSO's 2013 *Internal Control—Integrated Framework*.

[17] See paragraph 11.05 of *Standards for Internal Control in the Federal Government*.

- Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

.A11 Other inherent risk factors that affect susceptibility of an assertion to misstatement about a class of transactions, account balance, or disclosure may include one or both of the following:

- The quantitative or qualitative significance of the class of transactions, account balance, or disclosure
- The volume or a lack of uniformity in the composition of the items to be processed through the class of transactions or account balance, or to be reflected in the disclosure

Relevant Assertions

.A12 A risk of material misstatement may relate to more than one assertion, in which case, all the assertions to which such a risk relates are relevant assertions. For the purposes of the AU-C sections, a risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).[18] There is a reasonable possibility when the likelihood of a material misstatement occurring is more than remote. If an assertion does not have an identified risk of material misstatement, then it is not a relevant assertion.

Risks Arising From the Use of IT

.A13 Appendix E, "Considerations for Understanding IT," sets out further considerations relating to understanding IT.

Significant Class of Transactions, Account Balance, or Disclosure

.A14 A class of transactions, account balance, or disclosure is considered significant when it has an identified risk of material misstatement at the assertion level (that is, there is one or more relevant assertions). The determination of whether a class of transactions, account balance, or disclosure is significant is made before consideration of any related controls (that is, the determination is based on inherent risk).

Significant Risk

.A15 *Significance* can be described as the relative importance of a matter and is judged by the auditor in the context in which the matter is being considered. For inherent risk, significance may be considered in the context of how, and the degree to which, inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur. The determination of significant risks allows for the auditor to focus more attention on those

[18]Paragraphs .A41–.A43 of section 200 and paragraph .07 of section 330.

risks that are close to the upper end of the spectrum of inherent risk through the performance of certain required responses (see paragraph .A247).

System of Internal Control

.A16 Internal control frameworks may use different terms that are similar to the concept of system of internal control. For example, the 2013 COSO framework and the Green Book define *internal control* similarly to the *system of internal control* in this section.

Risk Assessment Procedures and Related Activities (Ref: par. .13–.18)

.A17 The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this section. However, the significance of fraud is such that further requirements and guidance are included in section 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.[19] In addition, the following AU-C sections provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- Section 540, *Auditing Accounting Estimates and Related Disclosures*, with regard to accounting estimates
- Section 550, *Related Parties*, with regard to related party relationships and transaction
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, with regard to going concern
- Section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, with regard to group financial statements

.A18 Professional skepticism is necessary for the critical assessment of audit evidence gathered when performing risk assessment procedures. In addition, professional skepticism assists the auditor in remaining alert to audit evidence that is not biased towards corroborating the existence of risks or that may be contradictory. Professional skepticism is an attitude that is applied by the auditor when making professional judgments that then provides the basis for the auditor's actions. The auditor exercises professional judgment in determining when the auditor has audit evidence that provides an appropriate basis for risk assessment.

.A19 Examples of maintaining professional skepticism by the auditor may include the following:

- Considering information that may be used as audit evidence

[19] Paragraphs .12–.27 of section 240.

- Taking into account contradictory information that comes to the auditor's attention
- Considering responses to inquiries and other information obtained from management and those charged with governance
- Being alert to conditions that may indicate possible misstatement due to fraud or error
- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances

Why Obtaining Audit Evidence in an Unbiased Manner Is Important (Ref: par. .13)

.A20 Designing and performing risk assessment procedures to obtain audit evidence to support the identification and assessment of the risks of material misstatement in an unbiased manner may assist the auditor in identifying potentially contradictory information. This may also assist the auditor in maintaining professional skepticism in identifying and assessing the risks of material misstatement.

Sources of Audit Evidence (Ref: par. .13)

.A21 Designing and performing risk assessment procedures to obtain audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence. In addition to information from other sources,[20] sources of information for risk assessment procedures may include the following:

- Interactions with management, those charged with governance, and other key entity personnel, such as internal auditors
- Certain external parties such as regulators, whether obtained directly or indirectly
- Publicly available information about the entity, for example, entity-issued press releases, materials for analysts or investor group meetings, analysts' reports, or information about trading activity

Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with section 500, *Audit Evidence*.[21]

Scalability (Ref: par. .13)

.A22 The nature and extent of risk assessment procedures, including obtaining an understanding pursuant to the following requirements, will vary based on the nature and circumstances of the entity (for example, the formality of the entity's policies and procedures, and processes and systems):

[20] See paragraphs .A43–.A44 of this section.

[21] Paragraph .07 of section 500, *Audit Evidence*.

a. Performing risk assessment procedures (paragraph .19)

b. Understanding the components of internal control

   i. Control environment (paragraph .21)

   ii. The entity's risk assessment process (paragraphs .22–.23)

   iii. The entity's process to monitor the system of internal control (paragraph .24)

   iv. The information system and communication (paragraph .25)

   v. Control activities (paragraphs .26–.30)

The auditor exercises professional judgment to determine the nature and extent of the risk assessment procedures to be performed to meet the requirements of this section.

.A23 Some entities, including less complex entities, and particularly owner-managed entities, may not have established structured processes and systems (for example, a risk assessment process or a process to monitor the system of internal control) or may have established processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through observation and inquiry. Other entities, typically more complex entities, are expected to have more formalized and documented policies and procedures. The auditor may use such documentation in performing risk assessment procedures.

.A24 The nature and extent of risk assessment procedures to be performed in an initial audit may be more extensive than procedures for a recurring engagement. In subsequent periods, the auditor may focus on changes that have occurred since the preceding period.

Types of Risk Assessment Procedures (Ref: par. .14)

.A25 Section 500[22] explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing, and extent of the audit procedures may be affected by the fact that some of the accounting data and other evidence may be available only in electronic form or only at certain points in time.[23] The auditor may perform substantive procedures or tests of controls, in accordance with section 330, concurrently with risk assessment procedures, such as when it is efficient to do so. Audit evidence obtained that supports the identification and assessment of risks of material misstatement may also support the detection of misstatements at the assertion level or the evaluation of the operating effectiveness of controls.

.A26 Although the auditor is required to perform all the risk assessment procedures described in paragraph .14 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's

[22] Paragraphs .A14–.A17 and .A21–.A26 of section 500.

[23] Paragraph .A12 of section 500.

system of internal control (see paragraphs .19–.30), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed when the information to be obtained may be helpful in identifying risks of material misstatement. Examples of such procedures may include making inquiries of the entity's external legal counsel, or of valuation specialists that the entity has used.

Automated Tools and Techniques (Ref: par. .14)

.A27 Using automated tools and techniques, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, sub-ledgers, or other operational data), including for analysis, recalculations, reperformance, or reconciliations.

Inquiries of Management and Others Within the Entity (Ref: par. .14a)

Why Inquiries Are Made of Management and Others Within the Entity

.A28 Information obtained by the auditor to support an appropriate basis for the identification and assessment of risks, and the design of further audit procedures, may be obtained through inquiries of management and those responsible for financial reporting. As described in section 500, responses to inquiries may provide the auditor with information not previously possessed, with corroborative audit evidence, or with information that differs significantly from other information that the auditor has obtained.[24]

.A29 Inquiries of management and those responsible for financial reporting and of other appropriate individuals within the entity and other employees with different levels of authority may offer the auditor varying perspectives when identifying and assessing risks of material misstatement. Examples follow:

- Inquiries directed toward those charged with governance may help the auditor understand the extent of oversight by those charged with governance over the preparation of the financial statements by management. Section 260, *The Auditor's Communication With Those Charged With Governance*,[25] identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
- Inquiries of employees responsible for initiating, processing, or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed toward in-house legal counsel[26] may provide information about such matters as litigation; compliance with laws and regulations; knowledge of fraud or suspected fraud affecting the entity; warranties; post-sales obligations; arrangements (such as joint ventures) with business partners; and the meaning of contractual terms.

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[24] Paragraphs .A24–.A25 of section 500.

[25] Paragraph .A1 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[26] See paragraph .16 of section 501, *Audit Evidence — Specific Considerations for Selected Items*.

- Inquiries directed toward marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed toward the risk management function (or inquiries of those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed toward IT personnel may provide information about IT processes as well as system changes, system or control failures, or other IT-related risks.

Considerations Specific to Governmental Entities

.A30 When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of governmental entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity.

Inquiries of the Internal Audit Function (Ref: par. .14a)

Why Inquiries Are Made of the Internal Audit Function (If the Function Exists)

.A31 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may assist the auditor in understanding the entity and its environment, and the entity's system of internal control, in the identification and assessment of risks. Appendix D, "Considerations for Understanding an Entity's Internal Audit Function," sets out considerations for understanding an entity's internal audit function.

.A32 Some entities, for example, governmental entities, may have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function may assist the auditors in identifying the risk of material noncompliance with applicable laws and regulations and the risk of control deficiencies related to financial reporting.

Analytical Procedures (Ref: par. .14b)

Why Analytical Procedures Are Performed as a Risk Assessment Procedure

.A33 Analytical procedures help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

.A34 Analytical procedures performed as risk assessment procedures may, therefore, assist in identifying and assessing the risks of material misstatement by identifying aspects of the entity of which the auditor was unaware or understanding how inherent risk factors, such as change, affect susceptibility of assertions to misstatement.

Types of Analytical Procedures

.A35 Analytical procedures performed as risk assessment procedures may be as follows:

- Include both financial and nonfinancial information, for example, the relationship between sales and square footage of selling space or volume of goods sold (nonfinancial).
- Use data aggregated at a high level. Accordingly, the results of those analytical procedures may provide a broad initial indication about the likelihood and potential magnitude of a material misstatement. For example, in the audit of many entities, including those with less complex business models and processes, and a less complex information system, the auditor may perform a comparison of information, such as the change in interim or monthly account balances from balances in prior periods, to obtain an indication of potentially higher risk areas.

.A36 This section addresses the auditor's use of analytical procedures as risk assessment procedures. Section 520, *Analytical Procedures*, addresses the auditor's use of analytical procedures as substantive procedures (substantive analytical procedures) and the auditor's responsibility to perform analytical procedures near the end of the audit. Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of section 520. However, the requirements and application material in section 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

Automated Tools and Techniques

.A37 Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as *data analytics*. For example, the auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts or may perform a more advanced procedure by extracting data from the entity's information system, and further analyzing this data using visualization techniques to identify classes of transactions, account balances, or disclosures for which further specific risk assessment procedures may be warranted.

Observation and Inspection (Ref: par. .14c)

Why Observation and Inspection Are Performed as Risk Assessment Procedures

.A38 Observation and inspection may support, corroborate, or contradict inquiries of management and others and may also provide information about the entity and its environment.

Scalability

.A39 When policies or procedures are not documented, or the entity has less formalized controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control. Examples are as follows:

- The auditor may obtain an understanding of controls over an inventory count, even if they have not been documented by the entity, through a combination of inquiry and direct observation.
- The auditor may be able to observe segregation of duties.
- The auditor may be able to observe passwords being entered.

Observation and Inspection as Risk Assessment Procedures

.A40 Risk assessment procedures may include observation or inspection of the following:

- The entity's operations
- Internal documents (such as business plans and strategies), records, and internal control manuals
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings)
- The entity's premises and plant facilities
- Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph .A88)
- The behaviors and actions of management or those charged with governance (such as the observation of an audit committee meeting)

Automated Tools or Techniques

.A41 Automated tools or techniques may also be used to observe or inspect particular assets. For example, such tools and techniques may include the use of remote observation tools, such as a video camera or drone.

Considerations Specific to Governmental Entities

.A42 Risk assessment procedures performed by auditors of governmental entities may also include observation and inspection of documents prepared by management for the governing body, for example, documents related to performance reporting.

Information From Other Sources (Ref: par. .15)

Why the Auditor Considers Information From Other Sources

.A43 Information obtained from other sources may be relevant to the identification and assessment of the risks of material misstatement by providing information and insights about the following:

- The nature of the entity and its business risks, and what may have changed from previous periods
- The integrity and ethical values of management and those charged with governance, which may also be relevant to the auditor's understanding of the control environment
- The applicable financial reporting framework and its application to the nature and circumstances of the entity

Other Relevant Sources

.A44 Other relevant sources of information are as follows:

- The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement in accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, including the conclusions reached thereon.[27]
- Other engagements performed for the entity by the engagement partner. The engagement partner may have obtained knowledge relevant to the audit, including about the entity and its environment, when performing other engagements for the entity. Such engagements may include agreed-upon procedures engagements or other audit or assurance engagements, including engagements to address incremental reporting requirements in the jurisdiction.

Information From the Auditor's Previous Experience With the Entity and Previous Audits (Ref: par. .16)

Why Information From Previous Audits Is Important to the Current Audit

.A45 The auditor's previous experience with the entity and from audit procedures performed in previous audits may provide the auditor with information that is relevant to the auditor's determination of the nature and extent of risk assessment procedures, and the identification and assessment of risks of material misstatement.

Nature of the Information From Previous Audits

.A46 The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about the following matters:

[27] Paragraph .14 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- Past misstatements and whether they were corrected on a timely basis
- The nature of the entity and its environment, and the entity's system of internal control (including control deficiencies)
- Significant changes that the entity or its operations may have undergone since the prior financial period
- Those particular types of transactions and other events or account balances (and related disclosures) in which the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity

.A47 The auditor is required to determine whether information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. If the nature or circumstances of the entity have changed, or new information has been obtained, the information from prior periods may no longer be relevant or reliable for the current audit. To determine whether changes have occurred that may affect the relevance or reliability of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of the applicable information-processing activities in the information system.

Engagement Team Discussion (Ref: par. .17–.18)

Why the Engagement Team Is Required to Discuss the Application of the Applicable Financial Reporting Framework and the Susceptibility of the Entity's Financial Statements to Material Misstatement

.A48 Key engagement team members include those members who have significant engagement responsibilities, including the engagement partner. The manner in which the discussion is conducted depends on the individuals involved and the circumstances of the engagement. For example, if the audit involves more than one location, there could be multiple discussions with team members in different locations.

.A49 The discussion among the engagement team about the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement accomplishes the following:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject, how inherent risk factors may affect the susceptibility of classes of transactions, account balances, and disclosures to misstatement, and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.

- Assists the engagement team members in gaining a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures. In particular, the discussion assists engagement team members in further considering contradictory information based on each member's own understanding of the nature and circumstances of the entity.
- Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

Section 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.[28]

.A50 Professional skepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the auditor identifies specific areas of the audit for which maintaining professional skepticism may be particularly important and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

.A51 As part of the discussion among the engagement team, consideration may also be given to additional broader objectives, and related risks, arising from specific audit requirements, for example, those related to governmental entities.

Scalability

.A52 When the engagement is carried out by a single individual, such as a sole practitioner (that is, when an engagement team discussion would not be possible), consideration of the matters referred to in paragraphs .A49 and .A54, nonetheless, may assist the auditor in identifying where there may be risks of material misstatement.

.A53 When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge and those responsible for the audits of components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed to by the engagement partner, may be useful.

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[28]Paragraph .15 of section 240.

Discussion of Disclosures in the Applicable Financial Reporting Framework

.A54 As part of the discussion among the engagement team, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances in which the applicable financial reporting framework requires only simplified disclosures. Matters the engagement team may discuss include the following:

- Changes in financial reporting requirements that may result in significant, new, or revised disclosures
- Changes in the entity's environment, financial condition, or activities that may result in significant, new, or revised disclosures, for example, a significant business combination in the period under audit
- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past
- Disclosures about complex matters, including those involving significant management judgment about what information to disclose

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: par. .19–.31)

.A55 Appendixes A–F set out further considerations relating to obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control.

Obtaining the Required Understanding (Ref: par. .19–.31)

.A56 Obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control is a dynamic and iterative process of gathering, updating, and analyzing information and continues throughout the audit. Therefore, the auditor's expectations may change as new information is obtained.

.A57 The auditor's understanding of the entity and its environment and the applicable financial reporting framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant classes of transactions, account balances, and disclosures. These expected significant classes of transactions, account balances, and disclosures form the basis for the scope of the auditor's understanding of the entity's information system.

Why an Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework, Is Required (Ref: par. .19–.20)

.A58 The auditor's understanding of the entity and its environment and the applicable financial reporting framework assist the auditor

a. in understanding the events and conditions that are relevant to the entity, and

b. in identifying how inherent risk factors affect the susceptibility of assertions to misstatement in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so.

Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit, exercising professional judgment, and maintaining professional skepticism throughout the audit, for example, when

- identifying and assessing risks of material misstatement of the financial statements in accordance with this section or other relevant AU-C sections (for example, relating to risks of fraud in accordance with section 240 or when identifying or assessing risks related to accounting estimates in accordance with section 540);
- performing procedures to help identify instances of noncompliance with laws and regulations that may have a material effect on the financial statements in accordance with section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*;[29]
- evaluating whether the financial statements provide adequate disclosures in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*;[30]
- determining materiality or performance materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*;[31] or
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures.

.A59 The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, also informs how the auditor plans and performs further audit procedures, for example, when

- developing expectations for use when performing substantive analytical procedures in accordance with section 520;[32]
- designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with section 330;[33] and
- evaluating the sufficiency and appropriateness of audit evidence obtained (for example, relating to assumptions or management's oral and written representations).

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[29]Paragraph .14 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

[30]Paragraph .15*e* of section 700, *Forming an Opinion and Reporting on Financial Statements*.

[31]Paragraphs .10–.11 of section 320, *Materiality in Planning and Performing an Audit*.

[32]Paragraph .05 of section 520, *Analytical Procedures*.

[33]Paragraphs .06–.07 of section 330.

Scalability (Ref: par. .19–.20)

.A60 The nature and extent of the required understanding is a matter of the auditor's professional judgment and varies from entity to entity based on the nature and circumstances of the entity, including the following:

- The size and complexity of the entity, including its IT environment
- The auditor's previous experience with the entity
- The nature of the entity's systems and processes, including whether they are formalized or not
- The nature and form of the entity's documentation

.A61 The auditor's risk assessment procedures to obtain the required understanding may be less extensive in audits of less complex entities and more extensive for entities that are more complex. The depth of the understanding that is required by the auditor is expected to be less than that possessed by management in managing the entity.

.A62 Some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial statements. However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment and the applicable financial reporting framework as it applies to the entity.

.A63 The entity's use of IT and the nature and extent of changes in the IT environment, including the risks arising from the use of IT identified in accordance with paragraph .29*a*, may also affect the specialized skills that are needed to assist with obtaining the required understanding, including the entity's general IT controls to be identified in accordance with paragraph .29*b*.

The Entity and Its Environment (Ref: par. .19)

The Entity's Organizational Structure, Ownership and Governance, and Business Model (Ref: par. .19a(i))

The Entity's Organizational Structure and Ownership (Ref: par. .19*a*(i))

.A64 An understanding of the entity's organizational structure and ownership may enable the auditor to understand the following matters:

- The complexity of the entity's structure. For example, the entity may be a single entity or the entity's structure may include subsidiaries, divisions, or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or variable interest entities are accounted for appropriately and whether adequate disclosure of such issues in the financial statements has been made.

- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial statements.[34]
- The distinction between the owners, those charged with governance and management. For example, in some less complex entities, owners of the entity may be involved in managing the entity, therefore, there is little or no distinction. In contrast, such as in some larger entities with diverse ownership, there may be a clear distinction between management, the owners of the entity, and those charged with governance. Even in some larger entities, owners of the entity may be involved in managing the entity. Section 260 provides guidance on the identification of those charged with governance and explains that, in some cases, some or all of those charged with governance may be involved in managing the entity.[35]
- The structure and complexity of the entity's IT environment. For example, an entity may

— have multiple legacy IT systems in diverse businesses that are not well integrated, resulting in a complex IT environment.

— be using external or internal service providers for aspects of its IT environment (for example, outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group).

<u>Automated Tools and Techniques</u>

.A65 The auditor may use automated tools and techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organizational structure or those with whom the entity conducts business (for example, vendors, customers, or related parties).

Considerations Specific to Governmental Entities

.A66 Ownership of a governmental entity may not have the same relevance as in the private sector because many governmental entities do not have owners or because decisions related to the entity may be made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions and the ability of other governmental entities to control or influence the entity's mandate and strategic direction. For example, a governmental entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and

[34] Section 550 addresses the auditor's considerations relevant to related parties.

[35] Paragraphs .A6–.A7 of section 260.

regulations, and the classification of the entity (that is, whether the entity is a department, agency, or other type of entity).

Governance (Ref: par. .19*a*(i))

Why the Auditor Obtains an Understanding of Governance

.A67 Understanding the entity's governance may assist the auditor with understanding the entity's ability to provide appropriate oversight of its system of internal control. This understanding, in connection with the auditor's understanding of the control environment, may also provide evidence of control deficiencies, which may indicate an increase in the susceptibility of the entity's financial statements to risks of material misstatement.

Understanding the Entity's Governance

.A68 The following matters may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity:

- Whether any or all of those charged with governance are involved in managing the entity and, if applicable, how those charged with governance demonstrate independence from management
- The existence (and separation) of a non-executive board, if any, from executive management
- Whether those charged with governance hold positions that are an integral part of the entity's legal structure, for example, as directors
- The existence of subgroups of those charged with governance, such as an audit committee, and the responsibilities of such a group
- The responsibilities of those charged with governance for oversight of financial reporting, including approving the financial statements or monitoring the entity's internal control related to financial reporting

The Entity's Business Model (Ref: par. .19*a*(i))

.A69 Appendixes A–B set out additional considerations for obtaining an understanding of the entity and its business model as well as additional considerations for auditing variable interest entities.

Why the Auditor Obtains an Understanding of the Entity's Business Model

.A70 Understanding the entity's objectives, strategy, and business model helps the auditor to understand the entity at a strategic level and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement because most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. For example, an entity's business model may rely on the use of IT in different ways:

- An entity sells shoes from a physical store and uses an advanced stock and point of sale system to record the selling of shoes.
- An entity sells shoes online so that all sales transactions are processed in an IT environment, including initiation of the transactions through a website.

The business risks arising from a significantly different business model would be substantially different, notwithstanding both entities sell shoes.

Understanding the Entity's Business Model

.A71 Not all aspects of the business model are relevant to the auditor's understanding. Business risks are broader than the risks of material misstatement of the financial statements, although business risks include the latter. The auditor does not have a responsibility to understand or identify all business risks because not all business risks give rise to risks of material misstatement.

.A72 Business risks could affect risks of material misstatement at the financial statement level or assertion level. For example, an entity's loss of financing or declining conditions affecting the entity's industry could affect its ability to settle its obligations when due and, thus, could affect the risks of material misstatement related to the classification of long-term liabilities or the valuation of long-term assets. It also could result in substantial doubt about the entity's ability to continue as a going concern. An unsuccessful new product or service or failed business expansion might affect the risks of material misstatement related to the valuation of inventory and other related assets.

.A73 Business risks increasing the susceptibility to risks of material misstatement may arise from the following:

- Inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity related to the entity's business
- A failure to recognize the need for change may also give rise to business risk, for example, from
  - — the development of new products or services that may fail;
  - — a market which, even if successfully developed, is inadequate to support a product or service; or
  - — flaws in a product or service that may result in legal liability and reputational risk
- Incentives and pressures on management, which may result in intentional or unintentional management bias and, therefore, affect the reasonableness of significant assumptions and the expectations of management or those charged with governance

.A74 Examples of matters that the auditor may consider when obtaining an understanding of the entity's business model, objectives, strategies, and related business risks that may result in a risk of material misstatement of the financial statements may include the following:

- Industry developments, such as the lack of personnel or expertise to deal with the changes in the industry
- New products and services that may lead to increased product liability
- Expansion of the entity's business, and demand has not been accurately estimated
- New accounting requirements in which there has been incomplete or improper implementation
- Regulatory requirements resulting in increased legal exposure
- Current and prospective financing requirements, such as loss of financing due to the entity's inability to meet requirements
- Use of IT, such as the implementation of a new IT system that will affect both operations and financial reporting
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements
- Climate-related events or conditions that may affect the entity in terms of its business model, its operations and processes, or its ability to raise financing or attract investment and customers

.A75 Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph .22 and .A124–.A129.

Considerations Specific to Governmental Entities

.A76 Entities operating in the governmental sector may create and deliver value in different ways from those creating wealth for owners but will still have an operating "model" with specific objectives. Matters that governmental sector auditors may obtain an understanding of that are relevant to the model of the entity include the following:

- Knowledge of relevant government activities, including related programs
- Program objectives and strategies, including public policy elements

.A77 For the audits of governmental entities, "management objectives" may be influenced by requirements to demonstrate public accountability and may include objectives that have their source in law, regulation, or other authority.

Industry, Regulatory, and Other External Factors (Ref: par. .19a(ii))

Industry Factors

.A78 Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. The following are matters the auditor may consider:

- The market and competition, including demand, capacity, and price competition
- Cyclical or seasonal activity
- Product technology relating to the entity's products
- Energy supply and cost

.A79 The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, in the construction industry, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with the appropriate competence and capabilities.[36]

Regulatory Factors (Ref: par. .19a(ii))

.A80 Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment and any changes thereto. The following are matters the auditor may consider:

- Regulatory framework for a regulated industry, including related disclosures
- Legislation and regulation that significantly affect the entity's operations, for example, labor laws and regulations
- Taxation legislation and regulations
- Government policies currently affecting the conduct of the entity's business, such as monetary policies, including foreign exchange controls, fiscal policies, financial incentives (for example, government aid programs), and tariffs or trade restriction policies
- Environmental requirements affecting the industry and the entity's business

.A81 Section 250 includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.[37]

Other External Factors (Ref: par. .19a(ii))

.A82 Other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

[36] Paragraph .16 of section 220.

[37] Paragraph .12 of section 250.

Measures Used by Management to Assess the Entity's Financial Performance (Ref: par. .19a(iii))

Why the Auditor Understands Measures Used by Management

.A83 An understanding of the entity's measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or fraud (for example, to improve the business performance or to intentionally misstate the financial statements) (see section 240 for requirements and guidance in relation to the risks of fraud).

.A84 Measures may also indicate to the auditor the likelihood of risks of material misstatement of related financial statement information. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

Measures Used by Management

.A85 Management and others ordinarily measure and review those matters they regard as important. Inquiries of management may reveal that it relies on certain key indicators, regardless of public availability, for evaluating financial performance and taking action. In such cases, the auditor may identify relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such inquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

.A86 Key indicators used for evaluating financial performance may include the following:

- Key performance indicators (financial and nonfinancial) and key ratios, trends, and operating statistics
- Period-on-period financial performance analyses
- Budgets, forecasts, variance analyses, segment information and divisional, departmental, or other level performance reports
- Employee performance measures and incentive compensation policies
- Comparisons of an entity's performance with that of competitors

Scalability (Ref: par. .19a(iii))

.A87 The procedures undertaken to understand the entity's measures may vary depending on the size or complexity of the entity as well as the involvement of owners or those charged with governance in the management of the entity.

Other Considerations

.A88 External parties may also review and analyze the entity's financial performance, in particular, for entities in which financial information is publicly available. The auditor may also consider publicly available information to help the auditor further understand the business or identify contradictory information, such as information from the following sources:

- Analysts or credit agencies
- News and other media, including social media
- Taxation authorities
- Regulators
- Trade unions
- Providers of finance

Such financial information can often be obtained from the entity being audited.

.A89 The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs .A130–.A139), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- In contrast, monitoring of the system of internal control is concerned with monitoring the effectiveness of controls, including those related to management's measurement and review of financial performance.

In some cases, however, performance indicators also provide information that enables management to identify control deficiencies.

Considerations Specific to Governmental Entities

.A90 In addition to considering relevant measures used by a governmental entity to assess the entity's financial performance, auditors of governmental entities may also consider nonfinancial information, such as achievement of public benefit outcomes (for example, the number of people assisted by a specific program).

*The Applicable Financial Reporting Framework (Ref: **par. .19b**)*

Understanding the Applicable Financial Reporting Framework and the Entity's Accounting Policies

.A91 Matters that the auditor may consider when obtaining an understanding of the entity's applicable financial reporting framework and how it applies in the context of the nature and circumstances of the entity and its environment include the following:

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as

- — accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances, and related disclosures in the financial statements (for example, loans and investments for banks or research and development for pharmaceuticals)
- — revenue recognition
- — accounting for financial instruments, including related credit losses
- — foreign currency assets, liabilities, and transactions
- — accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for cryptocurrency)

- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefor, may encompass the following matters:
  - — The methods the entity uses to recognize, measure, present, and disclose significant and unusual transactions
  - — The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus
  - — Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies
  - — Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements

.A92 Obtaining an understanding of the entity and its environment may assist the auditor in considering where changes in the entity's financial reporting (for example, from prior periods) may be expected. For example, if the entity has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances, and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period, the auditor's understanding may help confirm that the understanding obtained in the prior period remains applicable.

Considerations Specific to Governmental Entities

.A93 The applicable financial reporting framework for a governmental entity may be generally accepted accounting principles established by the Federal Accounting Standards Advisory Board or GASB, or a special purpose framework.

How Inherent Risk Factors Affect Susceptibility of Assertions to Misstatement (Ref: par. .19c)

.A94 Appendix B provides examples of events and conditions that may give rise to the existence of risks of material misstatement, categorized by inherent risk factor.

Why the Auditor Understands Inherent Risk Factors When Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework

.A95 Understanding the entity and its environment, and the applicable financial reporting framework, assists the auditor in identifying events or conditions, the characteristics of which may affect the susceptibility of assertions about classes of transactions, account balances, or disclosures to misstatement. These characteristics are inherent risk factors. Inherent risk factors may affect susceptibility of assertions to misstatement by influencing the likelihood of occurrence of a misstatement or the magnitude of the misstatement if it were to occur. Understanding how inherent risk factors affect the susceptibility of assertions to misstatement may assist the auditor with a preliminary understanding of the likelihood or magnitude of misstatements, which assists the auditor in identifying risks of material misstatement at the assertion level in accordance with paragraph .32*b*. Understanding the degree to which inherent risk factors affect susceptibility of assertions to misstatement also assists the auditor in assessing the likelihood and magnitude of a possible misstatement when assessing inherent risk in accordance with paragraph .35*a*. Accordingly, understanding the inherent risk factors may also assist the auditor in designing and performing further audit procedures in accordance with section 330.

.A96 The auditor's identification of risks of material misstatement at the assertion level and assessment of inherent risk may also be influenced by audit evidence obtained by the auditor in performing other risk assessment procedures, further audit procedures, or in fulfilling other requirements in GAAS.

The Effect of Inherent Risk Factors on a Class of Transactions, Account Balance, or Disclosure

.A97 The extent of susceptibility of a class of transactions, account balance, or disclosure to misstatement arising from complexity or subjectivity is often closely related to the extent to which it is subject to change or uncertainty. For example, if the entity has an accounting estimate that is based on assumptions, the selection of which are subject to significant judgment, the measurement of the accounting estimate is likely to be affected by both subjectivity and uncertainty.

.A98 The greater the extent to which a class of transactions, account balance, or disclosure is susceptible to misstatement because of complexity or subjectivity, the greater the need for the auditor to maintain professional skepticism. Further, when a class of transactions, account balance, or disclosure is susceptible to misstatement because of complexity, subjectivity, change, or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias. The auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among inherent risk factors.

.A99 Events or conditions that may affect susceptibility to misstatement due to management bias may also affect susceptibility to misstatement due to other fraud risk factors. Accordingly, this may be relevant information for use in accordance with section 240,[38] which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

Understanding the Components of the Entity's System of Internal Control (Ref: par. .21–.31)

.A100 Appendix C, "Understanding the Entity's System of Internal Control," further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix C also provides further explanation of the components of a system of internal control for purposes of GAAS.

.A101 The components of the entity's system of internal control for the purpose of this section may not necessarily reflect how an entity designs, implements, and maintains its system of internal control or how it may classify any particular component. Management might use an internal control framework specified by COSO, the Green Book, or another internal control framework with components that differ from the components identified in this section when designing, implementing, and maintaining the entity's system of internal control. In some instances, management may not use a framework at all. For the purpose of an audit, the auditor may use the framework used by management or may use different terminology or frameworks to describe the various aspects of a system of internal control and their effect on the audit, provided all the components described in this section are addressed.

.A102 Auditors of some entities may have additional responsibilities with respect to internal control. As a result, their considerations about the system of internal control may be broader and more detailed. For example, auditors of governmental entities may have responsibilities to report on compliance with law, regulation, or other authority.

How the Understanding of the Components of the Entity's System of Internal Control Differs From Understanding Specific Controls

.A103 The entity's system of internal control is a dynamic, iterative, and integrated process. Embedded within this process are controls consisting of policies and procedures. In an audit of financial statements, the components of the entity's system of internal control represent what is required to achieve the entity's financial reporting objectives. An audit does not require an understanding of all the processes or controls within each component.

.A104 For the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control components, the auditor's understanding includes the ongoing tasks and activities, or processes, geared to the achievement of the entity's financial reporting objectives. For the information system and communication component, the auditor's understanding includes the flows of transactions and other aspects of the entity's information-processing activities as well as the entity's communication of significant matters, as required by paragraph .25*a*–*b*. Audit evidence for the auditor's understanding and evaluation may be obtained through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the

[38]Paragraph .24 of section 240.

entity's processes through observation or inspection of documents). The auditor exercises professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements (see paragraph .A22 and .A108–.A109).

.A105 Controls within the information system and communication component and the control activities component of the entity's system of internal control are primarily more direct in addressing assertion level risks (see paragraphs .A5, .A140, and .A166). This section requires performing risk assessment procedures, beyond inquiry, to evaluate whether the controls identified in accordance with paragraphs .27 and .29 are effectively designed and determine whether those controls have been implemented (see paragraph .30). This evaluation involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material misstatements as well as establishing that the control exists and that the entity is using it (see paragraphs .A201–.A202). An audit does not require an understanding, including evaluating the design or determining the implementation, of all controls related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them.

.A106 The auditor may identify, in accordance with paragraphs .27 and .29, controls within the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A105, .A112, and .A170).

Scalability

.A107 The way in which the entity's system of internal control is designed, implemented, and maintained varies with an entity's size and complexity. For example, less complex entities may use less structured or simpler controls (that is, policies and procedures) to achieve their objectives.

.A108 The auditor's understanding of the entity's system of internal control is obtained through risk assessment procedures performed to understand and evaluate the components of the system of internal control as set out in paragraphs .21–.31. The nature, timing, and extent of procedures that are necessary to understand and evaluate the components of the entity's system of internal control depend on the following:

a. The size and complexity of the entity

b. The auditor's existing knowledge of the entity's controls

c. The nature of the entity's controls, including the entity's use of IT

d. The nature and extent of changes in the entity's information systems and operations

e. The nature and form of the entity's documentation of its controls

IT in the Components of the Entity's System of Internal Control

.A109 Appendix E provides further guidance on understanding the entity's use of IT in the components of the system of internal control.

.A110 The overall objectives of the auditor do not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements (that is, manual and automated controls and other resources, including service organizations, used in the entity's system of internal control).

Understanding the Nature of the Components of the Entity's System of Internal Control

.A111 The auditor's understanding and evaluation of the components of the entity's system of internal control required by this section provides a preliminary understanding of how the entity identifies business risks relevant to financial reporting and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph .A96). The auditor's identification and assessment of the risks of material misstatement assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. Examples follow:

- The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components is more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
- The auditor's understanding of the entity's information system and communication, and the entity's control activities component, is more likely to affect the identification and assessment of risks of material misstatement at the assertion level.

Control Environment, the Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control (Ref: par. .21–.24)

.A112 The controls in the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control are primarily indirect controls (see paragraph .A5). However, controls within these components may vary in nature and precision and, therefore, some controls within these components may also be direct controls that address risks of material misstatement at the assertion level (see paragraph .A170).

Why the Auditor Is Required to Understand the Control Environment, The Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control

.A113 The control environment provides an overall foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the system of internal control. Similarly, the entity's risk assessment process and its process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control.

.A114 Because these components are foundational to the entity's system of internal control, deficiencies in their operation could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and evaluations of these components required by this section affect the auditor's identification and assessment of risks of material misstatement at the financial statement level and may also affect the identification and assessment of risks of material misstatement at the assertion level (see paragraphs .A118, .A127, and .A138). Risks of material misstatement at the financial statement level affect the auditor's design of overall responses, including, as explained in section 330, an influence on the nature, timing, and extent of the auditor's further procedures.[39]

Obtaining an Understanding of the Control Environment (Ref: par. .21)

<u>Scalability</u>

.A115 The nature of the control environment in a less complex entity is likely to be different from the control environment in a more complex entity. For example, those charged with governance in less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager when there are no other owners. Accordingly, some considerations about the entity's control environment may be less relevant or may not be applicable.

.A116 In addition, audit evidence about elements of the control environment in less complex entities may not be available in documentary form, in particular, when communication between management and other personnel is informal, but the evidence may still be appropriately relevant and reliable in the circumstances. Examples are as follows:

- The organizational structure in a less complex entity will likely be simpler and may include a small number of employees involved in roles related to financial reporting.
- If the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant (see paragraph .A68).
- Less complex entities may not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Consequently, the attitudes, awareness, and actions of management or the owner-manager are of particular importance to the auditor's understanding of a less complex entity's control environment.

Understanding the Control Environment (Ref: par. .21a)

.A117 In considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through inquiries of management and employees and through considering information from external sources about

[39] Paragraphs .A1–.A3 of section 330.

- how management communicates to employees its views on business practices and ethical behavior, and
- inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.

Evaluating the Control Environment (Ref: par. .21b)

Why the Auditor Evaluates the Control Environment

.A118 The auditor's evaluation of how the entity demonstrates behavior consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential control deficiencies in the other components of the system of internal control. This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and, therefore, in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph .A111). The auditor may also identify control deficiencies in the control environment, the severity of which may be indicative of a fraud risk factor. In addition, the auditor's understanding and evaluation of the control environment required by this section may influence the controls the auditor might identify in accordance with paragraphs .27 and .29*b* based on the auditor's knowledge of the presence or absence of such controls in other components.

The Auditor's Evaluation of the Control Environment

.A119 The auditor's evaluation of the control environment is based on the understanding obtained in accordance with paragraph .21*a*. The evaluation is focused on the matters included in paragraph .21*b* and, therefore, does not require evaluating the design or determining the implementation of individual controls within the control environment. However, as described in paragraph .A106, the auditor may identify, in accordance with paragraphs .27–.29, controls within the control environment component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

.A120 Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which, in turn, may have a pervasive effect on the control environment. Such an effect may be positive or negative. For example, direct involvement by a single individual may be key to enabling the entity to meet its growth and other objectives and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.

.A121 The auditor may consider how the different elements of the control environment may be influenced by the philosophy and operating style of senior management, taking into account the involvement of independent members of those charged with governance.

.A122 Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud. For example, human resource policies and procedures directed toward hiring competent financial, accounting, and IT personnel may mitigate the risk of errors in processing and recording financial information. However, such policies and procedures may not mitigate the risk of management override of controls (for example, fraudulent financial reporting that involves senior management overstating earnings).

.A123 The auditor's evaluation of the control environment as it relates to the entity's use of IT may include such matters as the following:

- Whether governance over IT is commensurate with the nature and complexity of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting
- The management organizational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements or whether a sufficient number of appropriately skilled individuals have been employed, including when the entity uses commercial software [with no or limited modifications])

Obtaining an Understanding of the Entity's Risk Assessment Process (Ref: par. .22–.23)

Understanding the Entity's Risk Assessment Process (Ref: par. .22*a*)

.A124 As explained in paragraph .A71, not all business risks give rise to risks of material misstatement, whether due to error or fraud. In understanding how management and those charged with governance have identified business risks relevant to the preparation of the financial statements, and decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, has done the following:

- Specified the entity's objectives with sufficient precision and clarity to enable the identification and assessment of the risks relating to the objectives
- Identified the risks to achieving the entity's objectives and analyzed the risks as a basis for determining how the risks should be managed
- Assessed changes that could significantly affect the system of internal control
- Considered the potential for fraud when considering the risks to achieving the entity's objectives[40]

.A125 Paragraph .22 of this section requires the auditor to obtain an understanding of the entity's process for identifying business risks. Section 240[41] requires the auditor to

[40]Paragraph .18 of section 240.

make inquiries of management regarding, among other things, management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist.

.A126 The auditor may consider the implications of such business risks for the preparation of the entity's financial statements and other aspects of its system of internal control.

Evaluating the Entity's Risk Assessment Process (Ref: par. .22*b*)

Why the Auditor Evaluates Whether the Entity's Risk Assessment Process Is Appropriate

.A127 The auditor's evaluation of the entity's risk assessment process may assist the auditor in understanding where the entity has identified risks and how the entity has responded to those risks. The auditor's evaluation of how the entity identifies its business risks and how it assesses and addresses those risks assists the auditor in understanding whether the risks faced by the entity have been identified, assessed, and addressed, as appropriate, to the nature and complexity of the entity. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph .A111).

Evaluating Whether the Entity's Risk Assessment Process Is Appropriate (Ref: par. .22*b*)

.A128 The auditor's evaluation of the appropriateness of the entity's risk assessment process is based on the understanding obtained in accordance with paragraph .22*a*. The evaluation is focused on the matters included in paragraph .22*b* and, therefore, does not require evaluating the design or determining the implementation of individual controls within the entity's risk assessment process. However, as described in paragraph .A101, the auditor may identify, in accordance with paragraphs .27 and .29*b*, controls within the entity's risk assessment process component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

Scalability

.A129 Whether the entity's risk assessment process is appropriate to the entity's circumstances, considering the nature and complexity of the entity, is a matter of the auditor's professional judgment. For example, in some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (for example, the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the marketplace to identify emerging business risks). The evidence of this risk assessment occurring in these types of entities is often not formally documented, but it may be evident from, for example, discussions the auditor has with management,

[41] Paragraph .17 of section 240.

corroborated by emails or other correspondence between management and other personnel, that management is, in fact, performing risk assessment procedures.

Obtaining an Understanding of the Entity's Process to Monitor the Entity's System of Internal Control (Ref: par. .24)

Scalability

.A130 In less complex entities, and in particular, owner-manager entities, the auditor's understanding of the entity's process to monitor the system of internal control is often focused on how management or the owner-manager is directly involved in operations because there may not be any other monitoring activities. For example, management may receive complaints from customers about inaccuracies in their monthly statement that alerts the owner-manager to issues with the timing of when customer payments are being recognized in the accounting records.

.A131 For entities in which there is no formal process for monitoring the system of internal control, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents, or detects and corrects, misstatements.

Understanding the Entity's Process to Monitor the System of Internal Control (Ref: par. .24*a*(i))

.A132 Matters that may be relevant for the auditor to consider when understanding how the entity monitors its system of internal control include the following:

- The design of the monitoring activities, for example, whether it is periodic or ongoing monitoring
- The performance and frequency of the monitoring activities
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective
- How identified control deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action

.A133 The auditor may also consider how the entity's process to monitor the system of internal control addresses monitoring information-processing controls that involve the use of IT. This may include, for example

- controls to monitor complex IT environments that
  - — evaluate the continuing design effectiveness of information-processing controls and modify them, as appropriate, for changes in conditions or
  - — evaluate the operating effectiveness of information-processing controls.

- controls that monitor the permissions applied in automated information-processing controls that enforce the segregation of duties.
- controls that monitor how errors or control deficiencies related to the automation of financial reporting are identified and addressed.

Understanding the Entity's Internal Audit Function (Ref: par. .24*a*(ii))

.A134 Appendix D sets out further considerations for understanding the entity's internal audit function.

.A135 The auditor's inquiries of appropriate individuals within the internal audit function help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's inquiries, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, section 610, *Using the Work of Internal Auditors*, applies.

Understanding the Sources of Information (Ref: par. .24b)

Other Sources of Information Used in the Entity's Process to Monitor the System of Internal Control

.A136 Management's monitoring activities may use information in communications from external parties, such as customer complaints or regulator comments, that may indicate problems or highlight areas in need of improvement.

Why the Auditor Is Required to Understand the Sources of Information Used for the Entity's Monitoring of the System of Internal Control

.A137 The auditor's understanding of the sources of information used by the entity in monitoring the entity's system of internal control, including whether the information used is relevant and reliable, assists the auditor in evaluating whether the entity's process to monitor the entity's system of internal control is appropriate. If management assumes that information used for monitoring is relevant and reliable without having a basis for that assumption, errors that may exist in the information could potentially lead management to draw incorrect conclusions from its monitoring activities.

Why the Auditor Evaluates Whether the Entity's Process to Monitor the System of Internal Control Is Appropriate (Ref: par. .24c)

Evaluating The Entity's Process to Monitor The System of Internal Control

.A138 The auditor's evaluation about how the entity undertakes ongoing and separate evaluations for monitoring the effectiveness of controls assists the auditor in understanding whether the other components of the entity's system of internal control are present and functioning and, therefore, assists with understanding the other components of the entity's system of internal control. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph .A111) and with designing tests of controls.[42]

Evaluating Whether the Entity's Process to Monitor the System of Internal Control Is Appropriate (Ref: par. .24*c*)

.A139 The auditor's evaluation of the appropriateness of the entity's process to monitor the system of internal control is based on the auditor's understanding of the entity's process to monitor the system of internal control. The evaluation is focused on the matters included in paragraph .24*c* and, therefore, does not require evaluating the design or determining the implementation of individual controls within the entity's process to monitor the system of internal control. However, as described in paragraph .A106, the auditor may identify, in accordance with paragraphs .27 and .29*b*, controls within the entity's process to monitor the system of internal control component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

Information System and Communication, and Control Activities (Ref: par. .25–.30)

.A140 The controls in the information system and communication, and control activities components are primarily direct controls (that is, controls that are sufficiently precise to prevent, detect, or correct misstatements at the assertion level).

Why the Auditor Is Required to Understand the Information System and Communication, and Controls in the Control Activities Component

.A141 The auditor is required to understand the entity's information system and communication because understanding the flows of transactions and other aspects of the entity's information-processing activities relevant to the preparation of the financial statements, and evaluating whether the component appropriately supports the preparation of the entity's financial statements, supports the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process (see paragraph .A111).

.A142 The auditor is required to identify specific controls in the control activities component, and evaluate the design and determine whether the controls have been implemented, because it assists the auditor's understanding about management's approach to addressing certain risks. Therefore, it provides a basis for the design and performance of

[42] Paragraph .08 of section 330.

further audit procedures responsive to these risks as required by section 330. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. Even when the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement (see paragraph .A210).

The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities

.A143 As explained in paragraph .A57, the auditor's understanding of the entity and its environment, and the applicable financial reporting framework, may assist the auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant classes of transactions, account balances, and disclosures. In obtaining an understanding of the information system and communication component in accordance with paragraph .25*a*, the auditor may use these initial expectations to determine the extent of understanding of the entity's information-processing activities to be obtained.

.A144 The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information-processing activities. This information and the information obtained from the auditor's evaluation of the information system and communication component required by this section may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified (see paragraph .A143).

.A145 In obtaining an understanding of how information relating to significant classes of transactions, account balances, and disclosures flows into, through, and out of the entity's information system, the auditor may also identify controls in the control activities component that are required to be identified in accordance with paragraph .27 or .29*b*. For example, the auditor's identification and evaluation of controls in the control activities component may first focus on controls over journal entries and other adjustments and controls that the auditor plans to test the operating effectiveness of in designing the nature, timing, and extent of substantive procedures.

.A146 The auditor's assessment of inherent risk may also influence the identification of controls in the control activities component. For example, controls that address significant risks may be identifiable only when the auditor has assessed inherent risk at the assertion level in accordance with paragraph .35. Furthermore, controls addressing risks for which the auditor has determined that substantive procedures alone do not provide sufficient appropriate audit evidence (in accordance with paragraph .37) may also be identifiable only once the auditor's inherent risk assessments have been undertaken.

.A147 The auditor's identification and assessment of risks of material misstatement at the assertion level is influenced by both of the following:

- The auditor's understanding of the entity's policies for its information-processing activities in the information system and communication component
- The auditor's identification and evaluation of controls in the control activities component

Obtaining an Understanding of the Information System and Communication (Ref: par. .25)

.A148 Appendix C[43] sets out further considerations relating to the information system and communication.

Scalability

.A149 The information system, and related business processes, in less complex entities are likely to be less sophisticated than in larger entities and are likely to involve a less complex IT environment; however, the role of the information system is just as important. For example, less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may, therefore, require less effort in an audit of a less complex entity and may involve a greater amount of inquiry than observation or inspection of documentation. The need to obtain an understanding, however, remains important to provide a basis for the design of further audit procedures in accordance with section 330 and may further assist the auditor in identifying or assessing risks of material misstatement (see paragraph .A111).

Obtaining an Understanding of the Information System (Ref: par. .25*a*)

.A150 Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. Understanding how the entity initiates transactions and captures information as part of the auditor's understanding of the information system may include information about the entity's systems (its policies) designed to address compliance and operations objectives because such information is relevant to the preparation of the financial statements. Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.

.A151 The auditor's understanding of the entity's information system and communication required under paragraph .25*a* results in obtaining an understanding of the process of reconciling detailed records to the general ledger.

.A152 Understanding the entity's information system also includes an understanding of the resources to be used in the entity's information-processing activities. Information about the human resources involved that may be relevant to understanding risks to the integrity of the information system include the following:

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[43]Paragraphs 15–20 of appendix C, "Understanding the Entity's System of Internal Control."

- The competence of the individuals undertaking the work
- Whether there are adequate resources
- Whether there is appropriate segregation of duties

.A153 Matters the auditor may consider when understanding the policies that define the flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the information system and communication component include the nature of

a. the data or information relating to transactions, other events, and conditions to be processed;

b. the information processing to maintain the integrity of that data or information; and

c. the information processes, personnel, and other resources used in processing information.

.A154 Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system in a manner that is appropriate to the entity's circumstances.

.A155 The auditor's understanding of the information system may be obtained in various ways and may include some or all of the following:

- Inquiries of relevant personnel about the procedures used to initiate, record, process, and report transactions or about the entity's financial reporting process
- Inspection of policy or process manuals or other documentation of the entity's information system
- Observation of the performance of the policies or procedures by entity's personnel
- Selecting transactions and tracing them through the applicable process in the information system (that is, performing a walk-through, as described in paragraphs .A204–.A205)

Automated Tools and Techniques

.A156 The auditor may also use automated techniques to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying automated tools or techniques to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.

Information Obtained From Outside of the General and Subsidiary Ledgers

.A157 Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information that the auditor may consider are as follows:

- Information obtained from lease agreements relevant to disclosures in the financial statements
- Information disclosed in the financial statements that is produced by an entity's risk management system
- Fair value information produced by management's specialists and disclosed in the financial statements
- Information disclosed in the financial statements that has been obtained from models or from other calculations used to develop accounting estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as
  - — assumptions developed internally that may affect an asset's useful life, or
  - — data such as interest rates that are affected by factors outside the control of the entity
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions
- Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's assessment of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern[44]

.A158 Certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system and exercises professional judgment in determining the necessary understanding.

<u>The Entity's Use of IT in the Information System</u>

Why Does the Auditor Understand the IT Environment Relevant to the Information System

[44]Paragraphs .21–.22 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

.A159 The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT.

.A160 The understanding of the entity's business model and how it integrates the use of IT may also provide useful context to the nature and extent of IT expected in the information system.

Understanding the Entity's Use of IT

.A161 The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system, may result from program changes to IT applications or direct changes to data in databases involved in processing or storing those transactions or information.

.A162 The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances, and disclosures flow into, through, and out of the entity's information system.

Obtaining an Understanding of the Entity's Communication (Ref: par. .25*b*)

Scalability

.A163 In more complex entities, information the auditor may consider when understanding the entity's communication may come from policy manuals and financial reporting manuals.

.A164 In less complex entities, communication may be less structured (for example, formal manuals may not be used) due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels facilitate the reporting of exceptions and acting on them.

Evaluating Whether the Relevant Aspects of the Information System Support the Preparation of the Entity's Financial Statements (Ref: par. .25*c*)

.A165 The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is based on the understanding obtained in paragraph .25*a*–*b*. The evaluation is focused on the matters included in paragraph .25*c* and, therefore, does not require evaluating the design or determining the implementation of individual controls within the information system and communication component. Appendix C[45] sets out further considerations relating to the information system and communication component.

[45] Paragraphs 15–20 of appendix C.

.A166 Controls within the information system and communication component are primarily more direct in addressing assertion level risks but may also be indirect controls (see paragraphs .A5, .A105, and .A140). In particular, information-processing controls, also known as *transaction controls*, directly support the actions to mitigate information-processing risks in an entity's business processes (see paragraphs .A7–.A8). As described in paragraph .A169, although the auditor's identification and evaluation of controls in the control activities component as required by paragraph .30 is focused on information-processing controls, the auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures.

Control Activities (Ref: par. .26–.31)

Controls in the Control Activities Component (Ref: par. .26)

.A167 Appendix C[46] sets out further considerations relating to controls in the control activities component.

.A168 In obtaining an understanding of the other components of internal control, the auditor may have identified some controls described in paragraphs .27 and .29*b*. The control activities component includes controls that are designed to ensure the proper application of policies (which are also controls) in all the other components of the entity's system of internal control and includes both direct and indirect controls. For example, the controls that an entity has established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.

.A169 The auditor's identification and evaluation of controls in the control activities component is focused on information-processing controls, which are controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information (that is, the completeness, accuracy, and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures.

.A170 Direct controls may exist in the control environment, the entity's risk assessment process, or the entity's process to monitor the system of internal control, which may be identified in accordance with paragraphs .27 and .29*b*. An example is a management review control designed to detect misstatements by using key performance indicators or other types of information to develop sufficiently precise expectations of reported amounts. The more indirect the relationship between controls that support other controls and the control that is being considered, the less effective that control may be in preventing, or detecting and correcting, related misstatements. For example, a sales manager's review of a summary

[46] Paragraphs 21–22 of appendix C.

of sales activity for specific stores by region ordinarily is indirectly related only to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in addressing those risks than controls more directly related thereto, such as matching shipping documents with billing documents.

.A171 Paragraphs .29*b* and .30 require the auditor to identify and evaluate general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT because general IT controls support the continued effective functioning of information-processing controls. A general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.

.A172 The following are controls that the auditor is required to identify and evaluate the design, and determine the implementation of, in accordance with paragraph .30:

- Controls that the auditor plans to test the operating effectiveness of in determining the nature, timing, and extent of substantive procedures. The evaluation of such controls provides the basis for the auditor's design of tests of controls in accordance with section 330. These controls also include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- Controls that address significant risks as well as controls over journal entries and other adjustments as required by section 240. The auditor's identification and evaluation of such controls may also influence the auditor's identification and assessment of the risks of material misstatement, including the identification of additional risks of material misstatement (see paragraph .A111). This understanding also provides the basis for the auditor's design of the nature, timing, and extent of substantive procedures that are responsive to the related assessed risks of material misstatement.
- Other controls that the auditor considers appropriate to enable the auditor to meet the objectives of paragraph .13 with respect to risks at the assertion level, based on the auditor's professional judgment.

.A173 Controls in the control activities component are required to be identified when such controls meet one or more of the criteria included in paragraphs .27 or .29*b*. Such identified controls are sometimes referred to by auditors as *relevant controls* or *key controls*. An audit does not require an understanding, including evaluating the design or determining the implementation, of all controls related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them (see paragraph .A103–.A106).

.A174 There might be more than one control that addresses the assessed risk of material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to identify all controls, including redundant controls, related to a relevant assertion, unless redundancy is, itself, a control objective related to addressing the risk of material misstatement.

Types of Controls in the Control Activities Component (Ref: par. .26)

.A175 Examples of controls in the control activities component include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.

.A176 Controls in the control activities component may also include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

.A177 Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organizational and functional levels.

Scalability (Ref: par. .26)

.A178 Controls in the control activities component for less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in less complex entities, more controls may be directly applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.

.A179 It may be less practicable to establish segregation of duties in less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in section 240, domination of management by a single individual can be a potential control deficiency because there is an opportunity for management override of controls.[47]

Controls That Address Risks of Material Misstatement at the Assertion Level (Ref: par. .27a)

Controls That Address Risks That Are Determined to Be Significant Risks (Ref: par. .27*a*)

.A180 Regardless of whether the auditor plans to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may provide a basis for the design and performance of substantive procedures responsive to significant risks as required by section 330.[48] Although risks relating to significant nonroutine or judgmental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks.

[47] Paragraph .A32 of section 240.

[48] Paragraph .22 of section 330.

For example, when there are nonroutine events, such as a significant business acquisition, consideration of the entity's response may include such matters as whether it has been referred to appropriate specialists (such as internal or external valuation specialists), whether an assessment has been made of the potential effect, and how the circumstances are to be disclosed in the financial statements. The auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from nonroutine or judgmental matters may include whether and how management responds to the risks. Such responses may include the following:

- Controls, such as a review of assumptions by senior management or specialists
- Documented processes for accounting estimations
- Approval by those charged with governance

.A181 Section 240[49] requires the auditor to understand controls related to assessed risks of material misstatement due to fraud (which are treated as significant risks) and further explains that it is important for the auditor to obtain an understanding of the controls that management has designed, implemented, and maintained to prevent and detect fraud.

Controls Over Journal Entries and Other Adjustments (Ref: par. .27*b*)

.A182 How an entity incorporates information from transaction processing in the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. Section 240 requires the auditor to obtain an understanding of the entity's financial reporting process and controls over journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.[50]

Automated Tools and Techniques

.A183 In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and, therefore, may be more easily identified through the use of automated techniques. For example, in the audit of a less complex entity, the auditor may be able to extract a total listing of all journal entries into a simple spreadsheet. It may then be possible for the auditor to sort the journal entries by applying a variety of filters such as currency amount, name of the preparer or reviewer, journal entries that gross up the balance sheet and income statement only, or viewing the listing by the date the journal entry was posted to the general ledger, to assist the auditor in designing responses to the risks identified related to journal entries.

Controls for Which the Auditor Plans to Test the Operating Effectiveness (Ref: par. .27*c*)

.A184 The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible to obtain sufficient appropriate audit

[49]Paragraphs .27 and .A37 of section 240.

[50]Paragraph .32 of section 240.

evidence through substantive procedures alone. The auditor is required, in accordance with section 330,[51] to design and perform tests of controls that address such risks of material misstatement when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are required to be identified and evaluated.

.A185 In other cases, when the auditor plans to take into account the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures in accordance with section 330, such controls are also required to be identified because section 330[52] requires the auditor to design and perform tests of those controls. For example, the auditor may plan to test the operating effectiveness of controls

- over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.
- over the accuracy and completeness of information produced by the entity (for example, controls over the preparation and maintenance of system-generated reports) to determine the reliability of that information, when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures.
- relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

.A186 The auditor's decision whether to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if control deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.

Other Controls That the Auditor Considers Appropriate (Ref: par. .27*d*)

.A187 In addition to the controls set out in paragraph .27*a*–*c*, the auditor may consider it appropriate to identify and evaluate the design and determine the implementation of other controls to have an appropriate basis for the identification and assessment of risks of material misstatement at the assertion level, in accordance with paragraph .13. Such controls may include some or all of the following:

- Controls that address risks assessed as higher on the spectrum of inherent risk but have not been determined to be a significant risk
- Controls related to reconciling detailed records to the general ledger
- Controls related to accounting estimates
- Complementary user entity controls, if using a service organization[53]

[51] Paragraph .08*b* of section 330.

[52] Paragraph .08*a* of section 330.

.A188 The auditor's knowledge about the presence or absence of controls obtained from the understanding of the other components may inform the auditor's professional judgment in determining the extent to which it is necessary to devote additional attention to other controls.

Identifying IT Applications and Other Aspects of the IT Environment, Risks Arising From the Use of IT, and General IT Controls (Ref: par. .29)

.A189 Appendix E includes examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

Identifying IT Applications and Other Aspects of the IT Environment (Ref: par. .29)

Why the Auditor Identifies Risks Arising From the Use of IT and General IT Controls Related to Identified IT Applications and Other Aspects of the IT Environment

.A190 For controls listed in paragraph .27, paragraph .29 requires the auditor to identify related IT applications and other aspects of the IT environment that are subject to the risks described in paragraph .29*a*. Paragraph .29*b* then requires the auditor to identify general IT controls that address such risks. Such identification is necessary in order for the auditor to effectively perform the evaluation of design and determination of implementation of identified controls in accordance with paragraph .30 because general IT controls that address these risks may affect the design and implementation of the controls identified in paragraph .27.

.A191 In understanding the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks, some or all of the following may be affected:

- *The auditor's decision about whether to test the operating effectiveness of controls to address risks of material misstatement at the assertion level*. For example, when general IT controls are not designed effectively or appropriately implemented to address risks arising from the use of IT (for example, controls do not appropriately prevent or detect unauthorized program changes or unauthorized access to IT applications), this may affect the auditor's decision to rely on automated controls within the affected IT applications.
- *The auditor's assessment of control risk at the assertion level*. For example, the ongoing operating effectiveness of an information-processing control may depend on certain general IT controls that prevent or detect unauthorized program changes to the IT information-processing control (that is, program change controls over the related IT application). In such circumstances, the expected operating effectiveness (or lack thereof) of the general IT control may affect the auditor's assessment of control risk (for example, control risk may be higher when such general IT controls are expected to be ineffective or if the auditor does not plan to test the general IT controls).

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[53]Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

- *The auditor's strategy for testing information produced by the entity that is produced by or involves information from the entity's IT applications*. For example, when information produced by the entity to be used as audit evidence is produced by IT applications, the auditor may determine to test controls over system-generated reports, including identification and testing of the general IT controls that address risks of inappropriate or unauthorized program changes or direct changes to the data in such reports.
- *The auditor's assessment of inherent risk at the assertion level*. For example, when there are significant or extensive programming changes to an IT application to address new or revised reporting requirements of the applicable financial reporting framework, this may be indicative of the complexity of the new requirements and their effect on the entity's financial statements. When such extensive programming or data changes occur, the IT application is also likely to be subject to risks arising from the use of IT.
- *The design of further audit procedures*. For example, if information-processing controls depend on general IT controls, the auditor may determine to test the operating effectiveness of the general IT controls, which will then require the design of tests of controls for such general IT controls. If, in the same circumstances, the auditor determines not to test the operating effectiveness of the general IT controls, or the general IT controls are expected to be ineffective, the related risks arising from the use of IT may need to be addressed through the design of substantive procedures. However, in such circumstances, the risks arising from the use of IT may not be able to be addressed when such risks relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. In addition, the auditor may need to consider the implications for the audit opinion.

Identifying IT Applications That Are Subject to Risks Arising From the Use of IT

.A192 For the IT applications relevant to the information system, understanding the nature and complexity of the specific IT processes and general IT controls that the entity has in place may assist the auditor in determining which IT applications the entity is relying upon to accurately process and maintain the integrity of information in the entity's information system. Such IT applications may be subject to risks arising from the use of IT.

.A193 Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances, and disclosures and whether management is relying on general IT controls to maintain the integrity of that information.

.A194 The controls identified by the auditor in accordance with paragraph .27 may depend on system-generated reports that contain information that is used in the operation of the controls. In such circumstances, the control owner might rely on controls over the preparation and maintenance of such reports or perform other procedures to verify the information is accurate and complete. Likewise, the auditor may obtain audit evidence about the accuracy and completeness of the information by directly testing the inputs and outputs of the system-generated reports, rather than rely on controls over the preparation and maintenance of such reports. In such circumstances, the auditor may not identify the related IT applications as being subject to risks arising from the use of IT and, thus, such controls may not be subject to the requirement in paragraph .29*b*.

Scalability

.A195 The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and circumstances of the entity and its IT environment and will also be based on the nature and extent of controls identified by the auditor. The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors. Examples are as follows:

- An entity that uses commercial software and does not have access to the source code to make any program changes is unlikely to have a process for program changes but may have a process or procedures to configure the software (for example, the chart of accounts, reporting parameters, or thresholds). In addition, the entity may have a process or procedures to manage access to the application (for example, a designated individual with administrative access to the commercial software). In such circumstances, the entity is unlikely to have formalized general IT controls.
- In contrast, an entity may use multiple IT applications, and the IT processes to manage the IT environment may be complex (for example, a dedicated IT department exists that develops and implements program changes and manages access rights). In such circumstances, the entity likely has implemented formalized general IT controls over its IT processes.
- When management is not relying on automated controls or general IT controls to support complete and accurate transaction processing or maintain the data, and the auditor has not identified any automated controls or other information-processing controls (or any that depend on general IT controls), the auditor may plan to directly test any information produced by the entity involving IT and may not identify any IT applications that are subject to risks arising from the use of IT.
- When management relies on an IT application to process or maintain data and the volume of data is significant, and management relies upon the IT application to perform automated controls that the auditor has also identified, the IT application is likely to be subject to risks arising from the use of IT.

See paragraph 15 of appendix E for examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

.A196 When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialized skills or knowledge in IT. Such involvement is likely to be essential and may need to be extensive for complex IT environments.

Identifying Other Aspects of the IT Environment That Are Subject to Risks Arising From the Use of IT

.A197 The other aspects of the IT environment that may be subject to risks arising from the use of IT include the network, operating system and databases, and, in certain circumstances, interfaces between IT applications. Other aspects of the IT environment are generally not identified when the auditor does not identify IT applications that are subject to risks arising from the use of IT. When the auditor has identified IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment (for example, database, operating system, network) are likely to be identified because such aspects support and interact with the identified IT applications.

Identifying Risks Arising From the Use of IT and General IT Controls (Ref: par. .29)

.A198 Appendix F, "Considerations for Understanding General IT Controls," sets out considerations for understanding general IT controls.

.A199 In identifying the risks arising from the use of IT, the auditor may consider the nature of the identified IT application or other aspect of the IT environment and the reasons for it being subject to risks arising from the use of IT. For some identified IT applications or other aspects of the IT environment, the auditor may identify applicable risks arising from the use of IT that relate primarily to unauthorized access or unauthorized program changes as well as risks related to inappropriate data changes (for example, the risk of inappropriate changes to the data through direct database access or the ability to directly manipulate information).

.A200 The extent and nature of the applicable risks arising from the use of IT vary depending on the nature and characteristics of the identified IT applications and other aspects of the IT environment. Applicable IT risks may result when the entity uses external or internal service providers for identified aspects of its IT environment (for example, outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group). It is more likely that there will be more risks arising from the use of IT when the volume or complexity of automated application controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information. Applicable risks arising from the use of IT may also be identified related to cybersecurity.

Evaluating the Design and Determining Implementation of Identified Controls in the Control Activities Component (Ref: par. .30)

.A201 Evaluating the design of an identified control involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.

.A202 The auditor determines the implementation of an identified control by establishing that the control exists and that the entity is using it. There is little point in the auditor assessing the implementation of a control that is not designed effectively. Therefore, the auditor typically evaluates the design of a control first. An improperly designed control may represent a control deficiency.

.A203 Risk assessment procedures to obtain audit evidence about the design and implementation of identified controls in the control activities component may include

- inquiring of entity personnel.
- observing the performance of specific controls.
- inspecting documents and reports.
- reperforming the specific controls.

Inquiry alone, however, is not sufficient for such purposes.

.A204 A walk-through involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial records, using the same documents and IT that entity personnel use. Walk-throughs may assist the auditor in understanding the information system as required by paragraph .25 and in evaluating the design of controls that address the risks of material misstatement and determining whether those controls have been implemented as required by paragraph .30. Walk-through procedures usually include a combination of inquiry, observation, inspection of relevant documentation, and reperformance of controls. Such walk-throughs, as described in paragraph .A205, ordinarily are sufficient to evaluate design and determine implementation when risk assessment procedures beyond inquiry are performed.

.A205 In performing a walk-through, at the points at which important processing procedures occur, the auditor inquires of the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls particularly for the application of manual controls. These inquiries, combined with the other walk-through procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, inquiries that go beyond a narrow focus on the single transaction used as the basis for the walk-through allow the auditor to gain an understanding of the different types of significant transactions handled by the process.

.A206 The auditor may expect, based on experience from the previous audit or based on current period risk assessment procedures, that management does not have effectively designed or implemented controls to address a significant risk. In such instances, the procedures performed to address the requirement in paragraph .30 may consist of determining that such controls have not been effectively designed or implemented. If the results of the procedures indicate that controls have been newly designed or implemented, the auditor is required to perform the procedures in paragraph .30 on the newly designed or implemented controls.

.A207 The auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. However, when a control is not designed or implemented effectively, there is no benefit in testing it. When the auditor plans to test the operating effectiveness of a control, the information obtained about the extent to which the control addresses the risk or risks of material misstatement may be an input to the auditor's control risk assessment at the assertion level (see paragraph .A256).

.A208 Evaluating the design and determining the implementation of identified controls in the control activities component is not sufficient to test their operating effectiveness. However, for automated controls, if the procedures performed to evaluate the design of the controls and determine whether they have been implemented meets the requirements of a test of operating effectiveness in section 330,[54] the auditor may use the results of these procedures as a test of the operating effectiveness of the automated controls for the audit period if general IT controls provide for the consistent operation of the automated controls. Obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in section 330.[55]

.A209 When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's evaluation of the design and determination of the implementation of certain controls may still assist in the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement. Examples are as follows:

- These risk assessment procedures may provide a basis for the auditor's consideration of possible misstatements or likely sources of misstatements in a population when designing substantive procedures.
- These risk assessment procedures may lead the auditor to identify inadequate segregation of duties that may affect the design of the auditor's substantive procedures (for example, inadequate segregation of duties in the payroll function may indicate a fraud risk resulting from the ability to create fictitious employees for which the auditor's substantive procedures are required to be responsive to that risk).
- These risk assessment procedures may lead the auditor to identify missing controls that may affect the design of the auditor's substantive procedures (for example, the auditor may become aware that identified controls related to sales do not address the entity's bill-and-hold transactions with customers, resulting in different substantive procedures for such transactions)

.A210 In addition, when identified controls are designed effectively and implemented, risk assessment procedures may influence the auditor's determination of the nature and timing of substantive procedures to be performed (for example, the auditor may determine

[54] Paragraph .A34 of section 330.

[55] Paragraphs .08–.10 of section 330.

to perform inspection, rather than external confirmation or to perform procedures at an interim date, rather than at period end).

Control Deficiencies Within the Entity's System of Internal Control (Ref: par. .31)

.A211 In performing the evaluations required by paragraphs .21*b*, .22*b*, .24*c*#UUID-a1ba5383-a558-6e86-8df7-cfed793527c4_ad_315.21, .25*c*, and .30, the auditor may determine that certain of the entity's policies in a component are not appropriate to the nature and circumstances of the entity. Such determination may be an indicator that a control deficiency exists.

.A212 If the auditor has identified one or more control deficiencies, section 265, *Communicating Internal Control Related Matters Identified in an Audit*,[56] requires the auditor to determine whether, individually or in combination, the deficiencies constitute a material weakness or a significant deficiency. The auditor exercises professional judgment in determining whether a control deficiency represents a material weakness or a significant deficiency. Section 265 sets out indicators of material weaknesses and matters to be considered in determining whether a deficiency, or a combination of deficiencies, in internal control constitute a material weakness or a significant deficiency.[57]

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .32–.41)

Why the Auditor Identifies and Assesses the Risks of Material Misstatement

.A213 Risks of material misstatement are identified and assessed by the auditor in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

.A214 Information gathered by performing risk assessment procedures is used as audit evidence to provide the basis for the identification and assessment of the risks of material misstatement. For example, the audit evidence obtained when evaluating the design of identified controls and determining whether those controls have been implemented in the control activities component is used as audit evidence to support the risk assessment. Such evidence also provides a basis for the auditor to design overall responses to address the assessed risks of material misstatement at the financial statement level as well as designing and performing further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level, in accordance with section 330.

Identifying Risks of Material Misstatement (Ref: par. .32)

.A215 The identification of risks of material misstatement is performed before consideration of any related controls (that is, the determination is based on inherent risk) and is based on

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[56]Paragraph .08 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

[57]Paragraphs .A6–.A7 of section 265.

the auditor's preliminary consideration of misstatements that have a reasonable possibility of both occurring and being material if they were to occur.

.A216 Identifying the risks of material misstatement also provides the basis for the auditor's determination of relevant assertions, which assists the auditor's determination of the significant classes of transactions, account balances, and disclosures.

Assertions

Why the Auditor Uses Assertions

.A217 In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

The Use of Assertions

.A218 In identifying and assessing the risks of material misstatement, the auditor may use the categories of assertions as described in subsequent paragraph .A219*a–b* or may express them differently, provided all aspects described in paragraph .A219*a–b* have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances and related disclosures.

.A219 Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

a. Assertions about classes of transactions and events, and related disclosures, for the period under audit:

   i. *Occurrence.* Transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.

   ii. *Completeness.* All transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

   iii. *Accuracy*. Amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

   iv. *Cutoff*. Transactions and events have been recorded in the correct accounting period.

   v. *Classification*. Transactions and events have been recorded in the proper accounts.

   vi. *Presentation*. Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

b. Assertions about account balances, and related disclosures, at the period end:

   i. *Existence*. Assets, liabilities, and equity interests exist.

   ii. *Rights and obligations*. The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

   iii. *Completeness*. All assets, liabilities, and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

   iv. *Accuracy, valuation, and allocation.* Assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

   v. *Classification*. Assets, liabilities, and equity interests have been recorded in the proper accounts.

   vi. *Presentation.* Assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

.A220 The assertions described in preceding paragraph .A219*a–b*, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. For example, such a disclosure may be a description, required by the applicable financial reporting framework, of an entity's exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies, and processes for managing the risks; and the methods used to measure the risks.

Considerations Specific to Governmental Entities

.A221 When making assertions about the financial statements of governmental entities, in addition to those assertions set out in paragraph .A219*a–b*, management may often assert that transactions and events have been carried out in accordance with law, regulation, or other authority. Such assertions may fall within the scope of the financial statement audit.

Risks of Material Misstatement at the Financial Statement Level (Ref: par. .32a and .34)

Why the Auditor Identifies and Assesses Risks of Material Misstatement at the Financial Statement Level

.A222 The auditor identifies risks of material misstatement at the financial statement level to determine whether the risks have a pervasive effect on the financial statements and, therefore, would require an overall response in accordance with section 330.[58]

.A223 In addition, risks of material misstatement at the financial statement level may also affect individual assertions, and identifying these risks may assist the auditor in assessing risks of material misstatement at the assertion level and in designing further audit procedures to address the identified risks.

Identifying and Assessing Risks of Material Misstatement at the Financial Statement Level

.A224 Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level (for example, risk of management override of controls). Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level. The auditor's evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level. In other cases, a number of assertions may also be identified as susceptible to the risk and, therefore, may affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level (see paragraph .A246).

.A225 Depending upon the entity's nature and its environment, for example, governmental entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest, and sensitivity of programs or activities.

.A226 The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, in particular, the auditor's understanding of the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control, in addition to the following:

- The outcome of the related evaluations required by paragraphs .21*b*, .22*b*, .24*c*, and .25*c*
- Any control deficiencies identified in accordance with paragraph .31

In particular, risks at the financial statement level may arise from control deficiencies in the control environment or from external events or conditions such as declining economic conditions. For example, control deficiencies such as a lack of management competence or a lack of oversight over the preparation and fair presentation of the financial statements may have a more pervasive effect on the financial statements and may require an overall response by the auditor in accordance with section 330.[59]

.A227 Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level. For example, the auditor understands from inquiries of management that the entity's

[58] Paragraph .05 of section 330.

[59] Paragraph .05 of section 330.

financial statements are to be used in discussions with lenders in order to secure further financing to maintain working capital. The auditor also understands from such inquiries and other procedures that current loan agreements with these lenders contain financial covenants that the entity is at risk of failing to meet and identifies this condition as a fraud risk factor. Therefore, the auditor may determine that there is a greater susceptibility to misstatement due to this identified fraud risk factor, which affects inherent risk (that is, the susceptibility of the financial statements to material misstatement because of the risk of fraudulent financial reporting, such as overstatement of assets and revenue and understatement of liabilities and expenses to ensure that the covenants are met). The auditor may then identify assertion level risks with respect to existence, accuracy, or valuation of certain assets and completeness of certain liabilities that are susceptible to material misstatement as a result of this financial statement level risk.

.A228 The auditor's understanding, including the related evaluations, of the control environment and other components of the system of internal control may raise doubts about the auditor's ability to obtain audit evidence on which to base the audit opinion or be cause for withdrawal from the engagement when withdrawal is possible under applicable law or regulation. Examples are as follows:

- As a result of evaluating the entity's control environment, the auditor has concerns about the integrity of the entity's management, which may be so serious that it could cause the auditor to conclude that the risk of intentional misrepresentation by management in the financial statements is such that an audit cannot be conducted.
- As a result of evaluating the entity's information system and communication, the auditor determines that significant changes in the IT environment have been poorly managed, with little oversight from management and those charged with governance. The auditor concludes that there are significant concerns about the condition and reliability of the entity's accounting records. In such circumstances, the auditor may determine that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

.A229 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, establishes requirements and provides guidance in determining whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

Risks of Material Misstatement at the Assertion Level (Ref: par. .32b)

.A230 Appendix B sets out examples, in the context of inherent risk factors, of events or conditions that may indicate susceptibility to misstatement that may be material.

.A231 Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level. Assessed risks of material misstatement for the relevant assertions and the related significant classes of transactions, account balances, and disclosures are also referred to as *risks of material misstatement at the relevant assertion level*.

Relevant Assertions and Significant Classes of Transactions, Account Balances, and Disclosures (Ref: par. .33)

Why Relevant Assertions and Significant Classes of Transactions, Account Balances, and Disclosures Are Determined

.A232 Risks of material misstatement are assessed at the assertion level for significant classes of transactions, account balances, or disclosures in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. An approach to identifying and assessing risks of material misstatement may begin at the financial statement level and, with the auditor's overall understanding through risk assessment procedures, work down to significant classes of transactions, account balances, and disclosures and their relevant assertions. Further, determining the significant classes of transactions, account balances, and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained in accordance with paragraph .25*a*. As described in paragraph .A144, the information obtained from the auditor's understanding and evaluation of the information system and communication component required by this section may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified. This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see paragraph .A96).

Automated Tools and Techniques

.A233 The auditor may use automated techniques to assist in the identification of significant classes of transactions, account balances, and disclosures. Examples are as follows:

- An entire population of transactions may be analyzed using automated tools and techniques to understand their nature, source, size, and volume. By applying automated techniques, the auditor may, for example, identify that an account with a zero balance at period end comprised numerous offsetting transactions and journal entries occurring during the period, indicating that the account balance or class of transactions may be significant (for example, a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to management (and other employees), which could be a significant disclosure due to these payments being made to related parties.
- By analyzing the flows of an entire population of revenue transactions, the auditor may more easily identify a significant class of transactions that had not previously been identified.

Disclosures That May Be Significant

.A234 Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of disclosures that have qualitative aspects and that may have relevant assertions and, therefore, may be considered significant by the auditor include disclosures about the following:

- Accounting and reporting complexities associated with an account
- Exposure to losses in an account
- Significant contingent liabilities arising from the activities reflected in an account
- Liquidity and debt covenants of an entity in financial distress
- Events or circumstances that have led to the recognition of an impairment loss
- Key sources of estimation uncertainty, including assumptions about the future
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity
- Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures
- Related parties and related party transactions
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: par. .35–.37)

Assessing the Likelihood and Magnitude of Misstatement (Ref: par. .35)

Why the Auditor Assesses Likelihood and Magnitude of Misstatement

.A235 The auditor assesses the likelihood and magnitude of misstatement for identified risks of material misstatement because the significance of the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement were the misstatement to occur determines where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk.

.A236 Assessing the inherent risk of identified risks of material misstatement also assists the auditor in determining significant risks. The auditor determines significant risks because specific responses to significant risks are required in accordance with section 330 and other AU-C sections.

.A237 Inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of transactions, account balance, or disclosure is susceptible to material misstatement, the higher the inherent risk assessment is likely to be. Considering the degree to which inherent risk factors affect the susceptibility of an assertion to misstatement assists the auditor in appropriately assessing inherent risk for risks of material misstatement at the assertion level and in designing a more precise response to such a risk.

Spectrum of Inherent Risk

.A238 In assessing inherent risk, the auditor exercises professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement.

.A239 The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size, and complexity of the entity and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.

.A240 In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur based on consideration of the inherent risk factors.

.A241 In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (that is, misstatements in assertions about classes of transactions, account balances, or disclosures may be judged to be material due to size, nature, or circumstances).

.A242 The auditor uses the significance of the combination of the likelihood and magnitude of a possible misstatement in determining where on the spectrum of inherent risk (that is, the range) inherent risk is assessed. The higher the combination of likelihood and magnitude, the higher the assessment of inherent risk; the lower the combination of likelihood and magnitude, the lower the assessment of inherent risk.

.A243 For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example, a higher inherent risk assessment could result from a lower likelihood but a very high magnitude.

.A244 In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within categories along the spectrum of inherent risk, based on the auditor's assessment of inherent risk. These categories may be described in different ways, such as in quantitative terms or in nonquantitative terms. For example, the auditor may use percentages or classifications (for example, low, medium, or high; lower or higher; normal or elevated; or another type of nominal or arithmetic scale) to describe the level of inherent risk. Regardless of the method used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is appropriately responsive to the assessment of inherent risk and the reasons for that assessment.

Pervasive Risks of Material Misstatement at the Assertion Level (Ref: par. .35*b*)

.A245 In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial statements as a whole and potentially affect many assertions, in which case, the auditor may update the identification of risks of material misstatement at the financial statement level.

.A246 In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions and are identifiable with specific assertions, the auditor is required to take into account those risks when assessing inherent risk for risks of material misstatement at the assertion level. Further, identified risks of material misstatement at the financial statement level may affect the auditor's assessment of significant risks at the assertion level.[60] For example, an entity may face operating losses and liquidity issues and be reliant on funding that has not yet been secured. In such a circumstance, the financial reporting framework may require management to evaluate whether there is substantial doubt about the entity remaining a going concern, and the auditor may determine that there is a significant risk associated with the related disclosures in the entity's financial statements.

Significant Risks (Ref: par. .36)

Why Significant Risks Are Determined and the Implications for the Audit

.A247 The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk, through the performance of certain required responses, including the following:

- Controls that address significant risks are required to be identified in accordance with paragraph .27*a* of this section, with a requirement to evaluate whether the control has been designed effectively and implemented in accordance with paragraph .30 of this section.
- In addition to the requirements and guidance in this section, section 330 includes special audit considerations in the form of specific requirements related to significant risks because of the nature of the risk and the likelihood and potential magnitude of misstatement related to the risk. In this regard, section 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.[61]
- Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.[62]

[60] See paragraph .A214 of this section.

[61] Paragraphs .15 and .22 of section 330.

[62] Paragraph .07*b* of section 330.

- Section 260 requires communicating with those charged with governance about the significant risks identified by the auditor.[63]
- Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, if applicable, requires the auditor to take into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.[64]
- Section 600A requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.[65]

.A248 Timely review of audit documentation by the engagement partner at the appropriate stages during the audit allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report.[66]

Determining Significant Risks

.A249 In determining significant risks, the auditor may first identify those assessed risks of material misstatement that have been assessed higher on the spectrum of inherent risk to form the basis for considering which risks may be close to the upper end. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.

.A250 The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk and, therefore, are significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another AU-C section. Section 240 and section 550 provide further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud and related party transactions that are also significant unusual transactions.[67,68] Examples are as follows:

- Cash at a supermarket retailer would ordinarily be determined to be a high likelihood of possible misstatement (due to the risk of cash being misappropriated); however, the magnitude would typically be very low (due to the low levels of physical cash handled in the stores). The combination of these two factors on the spectrum of inherent risk would be unlikely to result in the existence of cash being determined to be a significant risk.

[63] Paragraph .11 of section 260.

[64] Paragraph .08 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

[65] Paragraphs .57–.58 of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

[66] Paragraphs .19 and .A17 of section 220.

[67] Paragraphs .25–.27 of section 240.

[68] Paragraph .18 of section 550.

- An entity is in negotiations to sell a business segment. The auditor considers the effect on goodwill impairment and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of inherent risk factors of subjectivity, uncertainty, and susceptibility to management bias or other fraud risk factors. This may result in goodwill impairment being determined to be a significant risk.

.A251 The auditor also takes into account the relative effects of inherent risk factors when assessing inherent risk. The lower the effect of inherent risk factors, the lower the assessed risk is likely to be. Risks of material misstatement that may be assessed as having higher inherent risk and, therefore, may be determined to be a significant risk, may arise from matters such as the following:

- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved
- Accounting estimates that have high estimation uncertainty or complex models[69]
- Accounting for unusual or complex transactions (for example, accounting for revenue with multiple performance obligations that are difficult to value)
- Emerging areas (for example, accounting for digital assets)
- Complexity in data collection and processing to support account balances
- Account balances or quantitative disclosures that involve complex calculations
- Accounting principles that may be subject to differing interpretation
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: par. .37)

Why Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence Are Required to Be Identified

.A252 Due to the nature of a risk of material misstatement, and the controls that address that risk, in some circumstances, the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures in accordance with section 330 to address risks of material misstatement at the assertion level.

.A253 Paragraph .27*c* also requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence because the auditor is required, in accordance with section 330,[70] to design and perform tests of such controls.

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[69] Paragraphs .10–.11 of section 540, *Auditing Accounting Estimates and Related Disclosures*.

Determining Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

.A254 When routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. This may be the case in circumstances in which a significant amount of an entity's information is initiated, recorded, processed, or reported in the financial statements only in electronic form. For example, it is typically not possible to obtain sufficient appropriate audit evidence relating to revenue for a telecommunications entity based on substantive procedures alone. This is because the evidence of call or data activity does not exist in a form that is observable. Instead, controls testing is typically performed to determine that the origination and completion of calls and data activity is correctly captured (for example, minutes of a call or volume of a download) and recorded correctly in the entity's billing system. In such cases

- audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- the potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

.A255 Section 540 provides further guidance related to accounting estimates about risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.[71] In relation to accounting estimates, this may not be limited to automated processing but may also be applicable to complex models.

Assessing Control Risk (Ref: par. .38)

.A256 The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design and the determination of implementation of the identified controls in the control activities component. The results of tests of the operating effectiveness of the controls in accordance with section 330 provide the basis for the auditor's determination of whether the initial expectation about the operating effectiveness of controls remains appropriate. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph .41.

.A257 The auditor's assessment of control risk may be performed in different ways, depending on preferred audit techniques or methodologies, and may be expressed in different ways. For instance, the control risk assessment may be expressed using qualitative terms (such as control risk assessed as maximum, moderate, or minimum) or in terms of the auditor's expectation of how effective the controls are in addressing the identified risk, that

[70]Paragraph .08 of section 330.

[71]Paragraphs .A87–.A89 of section 540.

is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls. In accordance with paragraph .38, tests of the operating effectiveness of controls are required to support a control risk assessment below the maximum level.

.A258 If the auditor plans to test the operating effectiveness of controls, it may be necessary to test a combination of controls to confirm the auditor's expectation that the controls are operating effectively. The auditor may plan to test both direct and indirect controls, including general IT controls and, if so, take into account the combined expected effect of the controls when assessing control risk. To the extent that the control to be tested does not fully address the assessed inherent risk, the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

.A259 When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level, and the auditor's further audit procedures may need to include substantive procedures to address the applicable risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in section 330.[72]

.A260 Regardless of whether the auditor plans to test the operating effectiveness of controls for the purpose of assessing control risk, the auditor's understanding of the entity and its environment, the financial reporting framework, and the entity's system of internal control informs the auditor's design of further audit procedures. Examples follow:

- The auditor's understanding of the entity's system of internal control may indicate that controls are not designed or implemented appropriately, or the entity's control environment does not support the effective operation of control. In this case, there is no point in testing the operating effectiveness of controls; the further audit procedures will consist solely of substantive procedures. If the auditor determines, pursuant to paragraph .37, that substantive procedures alone cannot provide sufficient appropriate audit evidence, the auditor may need to consider the effect on the auditor's report, as described in section 330.[73]
- The auditor's understanding of the entity's information system and communication will inform the auditor about the nature of documentation available for testing. For example, if the entity's records are all electronic, the auditor may design audit procedures differently than if the entity's records are in paper format.

[72]Paragraphs .A32–.A33 of section 330.

[73]Paragraph .29 of section 330.

Evaluating the Audit Evidence Obtained From the Risk Assessment Procedures (Ref: par. .39)

Why the Auditor Evaluates the Audit Evidence From the Risk Assessment Procedures

.A261 Audit evidence obtained from performing risk assessment procedures provides the basis for the identification and assessment of the risks of material misstatement. This provides the basis for the auditor's design of the nature, timing, and extent of further audit procedures responsive to the assessed risks of material misstatement at the relevant assertion level in accordance with section 330. Accordingly, the audit evidence obtained from the risk assessment procedures provides a basis for the identification and assessment of risks of material misstatement whether due to fraud or error at the financial statement and assertion levels.

The Evaluation of the Audit Evidence

.A262 Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.[74]

Professional Skepticism

.A263 In evaluating the audit evidence from the risk assessment procedures, the auditor considers whether sufficient understanding about the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control has been obtained to be able to identify the risks of material misstatement as well as whether there is any evidence that is contradictory that may indicate a risk of material misstatement.

Classes of Transactions, Account Balances, and Disclosures That Are Not Significant but Are Material (Ref: par. .40)

.A264 As explained in section 320,[75] materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances, and disclosures. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements.[76] For purposes of this section, classes of transactions, account balances, or disclosures are material if there is a substantial likelihood that omitting, misstating, or obscuring information about them would influence the judgment made by a reasonable user based on the financial statements.

.A265 There may be classes of transactions, account balances, or disclosures that are material but have not been determined to be significant classes of transactions, account

[74] Paragraph .A1 of section 500.

[75] Paragraph .A2 of section 320.

[76] Paragraph .04 of section 320.

balances, or disclosures (that is, there are no relevant assertions identified). For example, the entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the considerations in paragraph .A264.

Revision of Risk Assessment (Ref: par. .41)

.A266 During the audit, new or other information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the entity's risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures, the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity, and the further planned audit procedures may not be effective in detecting material misstatements. Section 330[77] provides further guidance about evaluating the operating effectiveness of controls.

Documentation (Ref: par. .42)

.A267 For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

.A268 Section 230, *Audit Documentation*, notes that among other considerations, although there may be no single way in which the auditor's professional skepticism is documented, the audit documentation may, nevertheless, provide evidence of such professional skepticism.[78] For example, when the audit evidence obtained from risk assessment procedures includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in evaluating whether the audit evidence provides an appropriate basis for the auditor's identification and assessment of the risks of material misstatement. Examples of other requirements in this section for which documentation may provide evidence of the auditor's professional skepticism include the following:

- Paragraph .13, which requires the auditor to design and perform risk assessment procedures in a manner that is not biased toward obtaining audit evidence that may corroborate the existence of risks or toward excluding audit evidence that may contradict the existence of risks
- Paragraph .17, which requires a discussion among key engagement team members of the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement

[77]Paragraphs .16–.17 of section 330.

[78]Paragraph .A9 of section 230.

- Paragraphs .19*b* and .20, which require the auditor to obtain an understanding of the reasons for any changes to the entity's accounting policies and to evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework
- Paragraphs .21*b*, .22*b*, .23*b*, .24*c*, .25*c*, and .31, which require the auditor to evaluate, based on the required understanding obtained, whether the components of the entity's system of internal control are appropriate to the entity's circumstances considering the nature and complexity of the entity, and to determine whether one or more control deficiencies have been identified
- Paragraph .39, which requires the auditor to take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management, and to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement
- Paragraph .40, which requires the auditor to evaluate, when applicable, whether the auditor's determination that there are no risks of material misstatement for a material class of transactions, account balance, or disclosure remains appropriate

Scalability (Ref: par. .42)

.A269 The form and extent of the auditor's documentation is influenced by the nature, size, and complexity of the entity and its system of internal control, availability of information from the entity, and the audit methodology and technology used in the course of the audit. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement. However, the auditor is not required to document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.

.A270 The manner in which the requirements of paragraph .42 are documented is for the auditor to determine exercising professional judgment.

.A271 The form, content, and extent of audit documentation that is sufficient to enable an experienced auditor having no previous experience with the audit to understand the nature, timing, and extent of the risk assessment procedures performed and the results of those procedures, including the conclusions reached and the rationale for the significant professional judgments made, depend on various factors. These factors include the need to document a conclusion or the basis for a conclusion otherwise not readily determinable from the documentation of the work performed or audit evidence obtained.[79] An example of such a circumstance may be the rationale for significant judgments related to the inherent risk of an identified risk of material misstatement, when such rationale is not otherwise evident from the audit documentation.

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[79]Paragraph .A4 of section 230.

.A272 For the audits of less complex entities, the form and extent of documentation may be simple and relatively brief. Such audit documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.[80] Similarly, for example, the results of the risk assessment may be documented separately or as part of the auditor's documentation of further audit procedures.[81]

.A273 Section 200 states that GAAS typically refer to the risks of material misstatement, rather than inherent risk and control risk separately.[82] However, this section requires inherent risk to be assessed separately from control risk to provide a basis for designing and performing audit procedures to respond to the assessed risks of material misstatement at the relevant assertion level in accordance with section 330. Accordingly, the auditor may, but is not required to, document a combined assessment of inherent risk and control risk (see paragraphs .A244 and .A257).

[80] Paragraphs .07, .09, and .A12 of section 300, *Planning an Audit*.

[81] Paragraph .30 of section 330.

[82] Paragraph .A44 of section 200.

Appendix A — Considerations for Understanding the Entity and Its Business Model (Ref: par. .A69–.A77)

.A274

This appendix explains the objectives and scope of the entity's business model and provides examples of matters that the auditor may consider in understanding the activities of the entity that may be included in the business model. The auditor's understanding of the entity's business model, and how it is affected by its business strategy and business objectives, may assist the auditor in identifying business risks that may have an effect on the financial statements. In addition, this may assist the auditor in identifying risks of material misstatement.

Objectives and Scope of an Entity's Business Model

1. An entity's business model describes how an entity considers, for example, its organizational structure, operations or scope of activities, business lines (including competitors and customers thereof), processes, growth opportunities, globalization, regulatory requirements, and technologies. The entity's business model describes how the entity creates, preserves, and captures financial or broader value for its stakeholders.

2. *Strategies* are the approaches by which management plans to achieve the entity's objectives, including how the entity plans to address the risks and opportunities that it faces. An entity's strategies are changed over time by management to respond to changes in its objectives and in the internal and external circumstances in which it operates.

3. A description of a business model typically includes the following:

- The scope of the entity's activities and why it does them
- The entity's structure and scale of its operations
- The markets or geographical or demographic spheres, and parts of the value chain, in which it operates, how it engages with those markets or spheres (main products, customer segments, and distribution methods), and the basis on which it competes
- The entity's business or operating processes (for example, investment, financing, and operating processes) employed in performing its activities, focusing on those parts of the business processes that are important in creating, preserving, or capturing value
- The resources (for example, financial, human, intellectual, environmental, and technological) and other inputs and relationships (for example, customers, competitors, suppliers, and employees) that are necessary or important to its success
- How the entity's business model integrates the use of IT in its interactions with customers, suppliers, lenders, and other stakeholders through IT interfaces and other technologies

4. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a significant fall in real estate market values may increase the risk of material misstatement associated with the valuation assertion for a lender of medium-term real estate–backed loans. However, the same risk, particularly in combination with a severe economic downturn that concurrently increases the underlying risk of lifetime credit losses on its loans, may also have a longer-term consequence. The resulting net exposure to credit losses may cast substantial doubt on the entity's ability to continue as a going concern. If so, this could have implications for management's, and the auditor's, conclusion regarding the appropriateness of the entity's use of the going concern basis of accounting and determination about whether substantial doubt exists; therefore, whether a business risk may result in a risk of material misstatement is considered in light of the entity's circumstances. Examples of events and conditions that may give rise to the existence of risks of material misstatement are indicated in appendix B, "Understanding Inherent Risk Factors."

Activities of the Entity

5. The following are some examples of matters that the auditor may consider when obtaining an understanding of the activities of the entity (included in the entity's business model):

a. Business operations:
   i. Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as internet sales and marketing activities
   ii. Conduct of operations (for example, stages and methods of production or activities exposed to environmental risks)
   iii. Alliances, joint ventures, and outsourcing activities
   iv. Geographic dispersion and industry segmentation
   v. Location of production facilities, warehouses, and offices, and location and quantities of inventories
   vi. Key customers and important suppliers of goods and services, employment arrangements (including the existence of union contracts, pension and other post-employment benefits, stock options or incentive bonus arrangements, and government regulation related to employment matters)
   vii. Research and development activities and expenditures
   viii. Transactions with related parties

b. Investments and investment activities:
   i. Planned or recently executed acquisitions or divestitures
   ii. Investments and dispositions of securities and loans
   iii. Capital investment activities

iv. Investments in nonconsolidated entities, including noncontrolled partnerships, joint ventures, and noncontrolled variable interest entities

c. Financing and financing activities:

i. Ownership structure of major subsidiaries and associated entities, including consolidated and nonconsolidated structures

ii. Debt structure and related terms, including off-balance-sheet financing arrangements and leasing arrangements

iii. Beneficial owners (local, foreign, business reputation, and experience) and related parties

iv. Use of derivative financial instruments

Nature of Variable Interest Entities

6. A *variable interest entity* is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitization of financial assets or to carry out research and development activities. It may take the form of a corporation, trust, partnership, or unincorporated entity. The entity on behalf of which the variable interest entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, whereas other parties may provide the funding to the latter. In some circumstances, a variable interest entity may be a related party of the entity.

7. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control or circumstances under which the variable interest entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the variable interest entity.

Appendix B — Understanding Inherent Risk Factors (Ref: par. .12, .19, .A9–.A11, .A34, .A69, .A94–.A99, and .A230)

.A275

This appendix provides further explanation about inherent risk factors as well as matters that the auditor may consider in understanding and applying the inherent risk factors in identifying and assessing the risks of material misstatement at the assertion level.

The Inherent Risk Factors

1. *Inherent risk factors* are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance, or disclosure, to misstatement, whether due to fraud or error, and before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors[1] insofar as they affect inherent risk. In obtaining the understanding of the entity and its environment, and the applicable financial reporting framework and entity's accounting policies, in accordance with paragraph .19*a*–*b*, the auditor also understands how inherent risk factors affect susceptibility of assertions to misstatement in the preparation of the financial statements.

2. Inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as *required information*) include the following:

- *Complexity*. Arises either from the nature of the information or in the way that the required information is prepared, including when such preparation processes are more inherently difficult to apply. For example, complexity may arise in one of the following circumstances:
  - — In calculating supplier rebate provisions because it may be necessary to take into account different commercial terms with many different suppliers or many interrelated commercial terms that are all relevant in calculating the rebates due.
  - — When there are many potential data sources with different characteristics used in making an accounting estimate, the processing of that data involves many interrelated steps and, therefore, the data is inherently more difficult to identify, capture, access, understand, or process.
- *Subjectivity*. Arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take and about the resulting information to include in the financial statements. Because of different approaches to preparing the required information, different outcomes could result from appropriately applying

[1]Paragraphs .A28–.A32 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

the requirements of the applicable financial reporting framework. As limitations in knowledge or data increase, the subjectivity in the judgments that could be made by reasonably knowledgeable and independent individuals and the diversity in possible outcomes of those judgments will also increase.

- *Change*. Results from events or conditions that, over time, affect the entity's business or the economic, accounting, regulatory, industry, or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information. Such events or conditions may occur during, or between, financial reporting periods. For example, change may result from developments in the requirements of the applicable financial reporting framework, in the entity and its business model, or in the environment in which the entity operates. Such change may affect management's assumptions and judgments, including as they relate to management's selection of accounting policies or how accounting estimates are made or related disclosures are determined.

- *Uncertainty*. Arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the most appropriate available data, when it is not. Constraints on the availability of knowledge or data, which are not within the control of management (subject to cost constraints where applicable) are sources of uncertainty, and their effect on the preparation of the required information cannot be eliminated. For example, estimation uncertainty arises when the required monetary amount cannot be determined with precision, and the outcome of the estimate is not known before the date the financial statements are finalized.

- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk*. Susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include incentives or pressures insofar as they affect inherent risk (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio) and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in section 240, *Consideration of Fraud in a Financial Statement Audit*.[2]

3. When complexity is an inherent risk factor, there may be an inherent need for more complex processes in preparing the information, and such processes may be inherently more

[2]Paragraphs .A1–.A5 of section 240.

difficult to apply. As a result, applying them may require specialized skills or knowledge and may require the use of a management's specialists.

4. When management judgment is more subjective, the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase. For example, significant management judgment may be involved in making accounting estimates that have been identified as having high estimation uncertainty, and conclusions regarding methods, data, and assumptions may reflect unintentional or intentional management bias.

Examples of Events or Conditions That May Give Rise to the Existence of Risks of Material Misstatement

5. The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement in the financial statements at the financial statement level or the assertion level. The examples, grouped by inherent risk factor, cover a broad range of events and conditions; however, not all events and conditions are relevant to every audit engagement, and the list of examples is not necessarily complete. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degrees.

Relevant inherent risk factor	Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level
Complexity	Regulatory: • Operations that are subject to a high degree of complex regulation Business model: • The existence of complex alliances and joint ventures Applicable financial reporting framework: • Accounting measurements that involve complex processes Transactions: • Use of off-balance-sheet financing, variable interest entities, and other complex financing arrangements
Subjectivity	Applicable financial reporting framework: • A wide range of possible measurement criteria of an accounting estimate, for example, management's recognition of depreciation or construction income and expenses • Management's selection of a valuation technique or model for a noncurrent asset, such as investment properties
Change	Economic conditions: • Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies Markets: • Operations exposed to volatile markets, for example, futures trading Customer loss: • Going concern and liquidity issues, including loss of significant customers Industry model: • Changes in the industry in which the entity operates Business model: • Changes in the supply chain • Developing or offering new products or services, or moving into new lines of business Geography:

Relevant inherent risk factor	Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level
	• Expanding into new locations Entity structure: • Changes in the entity, such as large acquisitions or reorganizations or other unusual events • Entities or business segments likely to be sold Human resources competence: • Changes in key personnel, including departure of key executives IT: • Changes in the IT environment • Installation of significant new IT systems related to financial reporting Applicable financial reporting framework: • Application of new accounting pronouncements Capital: • New constraints on the availability of capital and credit Regulatory: • Investigations into the entity's operations or financial results by regulatory or government bodies • Impact of new legislation related to environmental protection
Uncertainty	Reporting: • Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures • Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees, and environmental remediation
Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk	Reporting: • Incentives and pressures, or opportunities, for management and employees to engage in fraudulent financial reporting, including omission or obscuring, of significant information in disclosures. See appendix A, "Examples of Fraud Risk Factors," of section 240 for additional guidance regarding fraud risk factors Transactions: • Significant transactions with related parties

Relevant inherent risk factor	Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level
	• Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period end • Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold, and classification of marketable securities

Other events or conditions that may indicate risks of material misstatement at the financial statement level:

- Lack of personnel with appropriate accounting and financial reporting skills
- Control deficiencies, particularly in the control environment, the entity's risk assessment process, and the entity's process for monitoring the system of internal control, and especially those not addressed by management
- Past misstatements, history of errors, or a significant amount of adjustments at period end

Appendix C — Understanding the Entity's System of Internal Control (Ref: par. .12, .21–.31, .A100–.A212)

.A276

1. The entity's system of internal control may be reflected in policy and procedures manuals, systems and forms, and the information embedded therein, and is effected by people. The entity's system of internal control is implemented by management, those charged with governance, and other personnel based on the structure of the entity. The entity's system of internal control can be applied based on the decisions of management, those charged with governance, or other personnel and in the context of legal or regulatory requirements to the operating model of the entity, the legal entity structure, or a combination of these.

2. This appendix further explains the components of, as well as the limitations of, the entity's system of internal control as set out in paragraphs .12, .21–.31, and .A100–.A209 as they relate to a financial statement audit.

3. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but it may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. For example, controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of disclosures of contingencies in the financial statements.

Components of the Entity's System of Internal Control

Control Environment

4. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people, and provides the overall foundation for the operation of the other components of the entity's system of internal control.

5. An entity's control consciousness is influenced by those charged with governance because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. Therefore, the effectiveness of the design of the control environment in relation to participation by those charged with governance is influenced by such matters as the following:

- Their independence from management and their ability to evaluate the actions of management
- Whether they understand the entity's business transactions

- The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures

6. The control environment encompasses the following elements:

a. *How management's oversight responsibilities are carried out, such as creating and maintaining the entity's culture and demonstrating management's commitment to integrity and ethical values.* The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the products of the entity's ethical and behavioral standards or codes of conduct, as well as how they are communicated (for example, through policy statements), and how they are reinforced in practice (for example, through management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts). The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.

b. *When those charged with governance are separate from management, how those charged with governance demonstrate independence from management and exercise oversight of the entity's system of internal control.* An entity's control consciousness is influenced by those charged with governance. Considerations may include whether there are sufficient individuals who are independent from management and objective in their evaluations and decision making; how those charged with governance identify and accept oversight responsibilities and whether those charged with governance retain oversight responsibility for management's design, implementation, and conduct of the entity's system of internal control. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle-blower procedures.

c. *How the entity assigns authority and responsibility in pursuit of its objectives.* This may include the following considerations:

   - Key areas of authority and responsibility and appropriate lines of reporting
   - Policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties
   - Policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable

d. *How the entity attracts, develops, and retains competent individuals in alignment with its objectives.* This includes how the entity ensures the individuals have the knowledge and skills necessary to accomplish the tasks that define the individual's job, such as the following:

- Standards for recruiting the most qualified individuals, with an emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior
- Training policies that communicate prospective roles and responsibilities, including practices such as training schools and seminars that illustrate expected levels of performance and behavior
- Periodic performance appraisals driving promotions that demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility

e. *How the entity holds individuals accountable for their responsibilities in pursuit of the objectives of the entity's system of internal control.* This may be accomplished through some of the following examples:

- Mechanisms to communicate and hold individuals accountable for performance of controls responsibilities and implement corrective actions as necessary
- Establishing performance measures, incentives, and rewards for those responsible for the entity's system of internal control, including how the measures are evaluated and maintain their relevance
- How pressures associated with the achievement of control objectives affect the individual's responsibilities and performance measures
- How the individuals are disciplined as necessary

The appropriateness of the preceding matters will be different for every entity depending on its size, the complexity of its structure, and the nature of its activities.

The Entity's Risk Assessment Process

7. The entity's risk assessment process is an iterative process for identifying and analyzing risks to achieving the entity's objectives and forms the basis for how management or those charged with governance determine the risks to be managed.

8. For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements or considers risks of fraud.

9. Risks relevant to reliable financial reporting include external and internal events, transactions, or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial information consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks, or it may decide to assume a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- *Changes in operating environment.* Changes in the regulatory, economic, or operating environment can result in changes in competitive pressures and significantly different risks.
- *New personnel.* New personnel may have a different focus on or understanding of the entity's system of internal control.
- *New or revamped information system.* Significant and rapid changes in the information system can change the risk relating to the entity's system of internal control.
- *Rapid growth.* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology*. Incorporating new technologies into production processes or the information system may change the risk associated with the entity's system of internal control.
- *New business models, products, or activities.* Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with the entity's system of internal control.
- *Corporate restructurings.* Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with the entity's system of internal control.
- *Expanded foreign operations.* The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- *New accounting pronouncements.* Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.
- *Use of IT.* Risks relating to
    - — maintaining the integrity of data and information processing;
    - — risks to the entity's business strategy that arise if the entity's IT strategy does not effectively support the entity's business strategy; or
    - — changes or interruptions in the entity's IT environment, such as those related to turnover of IT personnel, when the entity does not make necessary updates to the IT environment, or such updates are not timely.
- *Environmental, social, and governance (ESG) issues.* ESG issues, such as climate change, may affect businesses in various industries. For example, climate events or conditions may affect an entity in terms of the following:
    - — Climate events or conditions may influence the entity's business model, including the entity's supply chain, resulting in different risks.

- — New technological developments to address climate change may have a significant impact on the industry, which may create new or unique risks related to the entity's operations or processes.
- — Governments may change climate-related laws and regulations that could affect risks related to taxation or the entity's business model through increased environmental requirements.
- — Climate events or conditions may affect risks related to general economic conditions, interest rates and availability of financing, commodity prices and inflation, or currency revaluation.

The Entity's Process to Monitor the System of Internal Control

10. The entity's process to monitor the system of internal control is a continual process to evaluate the effectiveness of the entity's system of internal control and to take necessary remedial actions on a timely basis. The entity's process to monitor the entity's system of internal control may consist of ongoing activities, separate evaluations (conducted periodically), or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and may include regular management and supervisory activities. The entity's process will likely vary in scope and frequency depending on the assessment of the risks by the entity.

11. The objectives and scope of internal audit functions typically include activities designed to evaluate or monitor the effectiveness of the entity's system of internal control.[1] The entity's process to monitor the entity's system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

12. Controls related to the entity's process to monitor the entity's system of internal control, including those that monitor underlying automated controls, may be automated or manual, or a combination of both. For example, an entity may use automated monitoring controls over access to certain technology with automated reports of unusual activity to management, who manually investigate identified anomalies.

13. When distinguishing between a monitoring activity and a control related to the information system, the underlying details of the activity are considered, especially when the activity involves some level of supervisory review. Supervisory reviews are not automatically classified as monitoring activities, and it may be a matter of judgment whether a review is classified as a control related to the information system or a monitoring activity. For example, the intent of a monthly completeness control would be to detect and

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[1]Section 610, *Using the Work of Internal Auditors*, and appendix D, "Considerations for Understanding an Entity's Internal Audit Function," of this section provide further guidance related to internal audit.

correct errors, whereas a monitoring activity would determine why errors are occurring and assign management the responsibility of fixing the process to prevent future errors. In simple terms, a control related to the information system responds to a specific risk, whereas a monitoring activity assesses whether controls within each of the five components of the entity's system of internal control are operating as intended.

14. Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of the entity's system of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider in performing monitoring activities any communications relating to the entity's system of internal control from external auditors.

The Information System and Communication

15. Business processes result in the transactions that are recorded, processed, and reported by the information system. An entity's business processes include the activities designed to

- develop, purchase, produce, sell, and distribute an entity's products and services;
- ensure compliance with laws and regulations; and
- record information, including accounting and financial reporting information.

16. The information system, and related business processes, includes the financial reporting process used to prepare the entity's financial statements, including disclosures.

17. The information system relevant to the preparation of the financial statements consists of activities and policies, and accounting and supporting records, designed and established to do the following:

- Initiate, record, and process entity transactions (as well as to capture, process, and disclose information about events and conditions other than transactions, such as changes in fair values or indicators of impairment) and to maintain accountability for the related assets, liabilities, and equity
- Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis
- Process and account for system overrides or bypasses to controls
- Incorporate information from transaction processing in the general ledger (for example, transferring of accumulated transactions from various data tables)
- Capture and process information relevant to the preparation of the financial statements for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of assets

- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized, and appropriately reported in the financial statements

18. The quality of information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.

19. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

20. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control relevant to financial reporting. It may include such matters as the extent to which personnel understand how their activities in the information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

Control Activities

21. Controls in the control activities component are identified in accordance with paragraphs .26–.27 and .29*b*. Such controls include information-processing controls and general IT controls, both of which may be manual or automated in nature. The greater the extent of automated controls, or controls involving automated aspects, that management uses and relies on in relation to its financial reporting, the more important it may become for the entity to implement general IT controls that address the continued functioning of the automated aspects of information-processing controls. Controls in the control activities component may pertain, for example, to the following:

- *Authorization and approvals.* An authorization affirms that a transaction is valid (that is, it represents an actual economic event or is within an entity's policy). An authorization typically takes the form of an approval by a higher level of management or of verification and a determination if the transaction is valid. For example, a supervisor approves an expense report after reviewing whether the expenses seem reasonable and within policy. An example of an automated approval is when an invoice unit cost is automatically compared with the related purchase order unit cost within a pre-established tolerance level. Invoices within the tolerance level are automatically approved for payment. Those invoices outside the tolerance level are flagged for additional investigation.
- *Reconciliations.* Reconciliations compare two or more data elements. If differences are identified, action is taken to bring the data into agreement. Reconciliations generally address the completeness or accuracy of processing transactions.
- *Verifications*. Verifications compare two or more items with each other or compare an item with a policy and will likely involve a follow-up action when the two items do

not match or the item is not consistent with policy. Verifications generally address the completeness, accuracy, or validity of processing transactions.

- *Physical or logical controls, including those that address security of assets against unauthorized access, acquisition, use, or disposal*. Controls that encompass the following:
  - — The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records
  - — The authorization for access to computer programs and data files (that is, logical access)
  - — The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security, and inventory counts with accounting records)
- The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation depends on circumstances such as when assets are highly susceptible to misappropriation.
  - *Segregation of duties*. Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

    For example, a manager authorizing credit sales is not responsible for maintaining accounts receivable records or handling cash receipts. If one person is able to perform all these activities he or she could, for example, create a fictitious sale that could go undetected. Similarly, salespersons should not have the ability to modify product price files or commission rates.

    Sometimes, segregation is not practical, cost effective, or feasible. For example, smaller and less complex entities may lack sufficient resources to achieve ideal segregation, and the cost of hiring additional staff may be prohibitive. In these situations, management may institute alternative controls. In the preceding example, if the salesperson can modify product price files, a detective control activity can be put in place to have personnel unrelated to the sales function periodically review whether and under what circumstances the salesperson changed prices.

22. Certain controls may depend on the existence of appropriate supervisory controls established by management or those charged with governance. For example, authorization controls may be delegated under established guidelines, such as investment criteria set by those charged with governance; alternatively, nonroutine transactions such as major acquisitions or divestments may require specific high-level approval, including, in some cases, that of shareholders.

Limitations of Internal Control

23. The entity's system of internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by the inherent limitations of internal control. These include the realities that human judgment in decision making can be faulty, and that breakdown in the entity's system of internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control. Equally, the operation of a control may not be effective, such as when information produced for the purposes of the entity's system of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

24. Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of controls. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in an IT application that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

25. Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Appendix D — Considerations for Understanding an Entity's Internal Audit Function (Ref: par. .A31–.A32 and .A134)

.A277

This appendix provides further considerations relating to understanding the entity's internal audit function when such a function exists.

Objectives and Scope of the Internal Audit Function

1. The objectives and scope of an internal audit function, the nature of its responsibilities, and its status within the organization, including the function's authority and accountability, vary widely and depend on the size, complexity, and structure of the entity and the requirements of management and, when applicable, those charged with governance. These matters may be set out in an internal audit charter or terms of reference.

2. The responsibilities of an internal audit function may include performing procedures and evaluating the results to provide assurance to management and those charged with governance regarding the design and effectiveness of risk management, the entity's system of internal control, and governance processes. If so, the internal audit function may play an important role in the entity's process to monitor the entity's system of internal control. However, the responsibilities of the internal audit function may be focused on evaluating the economy, efficiency, and effectiveness of operations and, if so, the work of the function may not directly relate to the entity's financial reporting.

Inquiries of the Internal Audit Function

3. If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the auditor in obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and in identifying and assessing risks of material misstatement at the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the auditor's understanding of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, the auditor's risk assessments, or other aspects of the audit. Therefore, the auditor's inquiries are made regardless of whether the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed.[1] Inquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process.

4. If, based on responses to the auditor's inquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit of the financial statements, the auditor may consider it appropriate to read related reports of the internal audit

[1]The relevant requirements are contained in section 610, *Using the Work of Internal Auditors*.

function. Examples of reports of the internal audit function that may be relevant include the function's strategy and planning documents and reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations.

5. In addition, in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*,[2] if the internal audit function provides information to the auditor regarding any actual, suspected, or alleged fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.

6. Appropriate individuals within the internal audit function with whom inquiries are made are those who, in the auditor's professional judgment, have the appropriate knowledge, experience, and authority, such as the chief internal audit executive or, depending on the circumstances, other personnel within the function. The auditor may also consider it appropriate to have periodic meetings with these individuals.

Consideration of the Internal Audit Function in Understanding the Control Environment

7. In understanding the control environment, the auditor may consider how management has responded to the findings and recommendations of the internal audit function regarding identified control deficiencies relevant to the preparation of the financial statements, including whether and how such responses have been implemented, and whether they have been subsequently evaluated by the internal audit function.

Understanding the Role That the Internal Audit Function Plays in the Entity's Process to Monitor the System of Internal Control

8. If the nature of the internal audit function's responsibilities and assurance activities are related to the entity's financial reporting, the auditor may also be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor in obtaining audit evidence. Auditors may be more likely to be able to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the complexity of the entity and the nature of its operations and has a direct reporting relationship to those charged with governance.

9. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, section 610, *Using the Work of Internal Auditors*, applies.

10. As further discussed in section 610, the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

[2] Paragraph .19 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

11. Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the auditor can be informed of significant matters that may come to the attention of the internal audit function when such matters may affect the work of the auditor. Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the auditor's attention. The auditor is then able to take such information into account in the auditor's identification and assessment of risks of material misstatement.

Appendix E — Considerations for Understanding IT (Ref: par. .12, .25*a*, .27–.29, .A109, and .A192)

.A278

This appendix provides further matters that the auditor may consider in understanding the entity's use of IT in its system of internal control.

Understanding the Entity's Use of IT in the Components of the Entity's System of Internal Control

1. An entity's system of internal control contains manual elements and automated elements (that is, manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. An entity's use of IT affects the manner in which the information relevant to the preparation of the financial statements in accordance with the applicable financial reporting framework is processed, stored, and communicated and, therefore, affects the manner in which the entity's system of internal control is designed and implemented. Each component of the entity's system of internal control may use some extent of IT.

Generally, IT benefits an entity's system of internal control by enabling an entity to do the following:

- Consistently apply predefined business rules and perform complex calculations when processing large volumes of transactions or data
- Enhance the timeliness, availability, and accuracy of information
- Facilitate the additional analysis of information
- Enhance the ability to monitor the performance of the entity's activities and its policies and procedures
- Reduce the risk that controls will be circumvented
- Enhance the ability to achieve effective segregation of duties by implementing security controls in IT applications, databases, and operating systems

2. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement and further audit procedures based thereon. Automated controls may be more reliable than manual controls because they cannot be as easily bypassed, ignored, or overridden, and they are also less prone to simple errors and mistakes. Automated controls may be more effective than manual controls in the following circumstances:

- High volume of recurring transactions, or in situations in which errors that can be anticipated or predicted can be prevented, or detected and corrected, through automation

- Controls in which the specific ways to perform the control can be adequately designed and automated

Understanding the Entity's Use of IT in the Information System (Ref: *par. .25* a *)*

3. The entity's information system may include the use of manual and automated elements, which also affect the manner in which transactions are initiated, recorded, processed, and incorporated in the general ledger and reported in the financial statements. In particular, procedures to initiate, record, process, and report transactions may be enforced through the IT applications used by the entity and how the entity has configured those applications. In addition, records in the form of digital information may replace or supplement records in the form of paper documents.

4. In obtaining an understanding of the IT environment relevant to the flows of transactions and information processing in the information system, the auditor gathers information about the nature and characteristics of the IT applications used as well as the supporting IT infrastructure and IT. This may include, for example, the complexity or level of customization related to IT applications, third-party hosting or outsourcing, and the use of interfaces, data warehouses, or report writers.

Emerging Technologies

5. Entities may use emerging technologies (for example, blockchain, robotics, or artificial intelligence) because such technologies may present specific opportunities to increase operational efficiencies or enhance financial reporting. When emerging technologies are used in the entity's information system relevant to the preparation of the financial statements, the auditor may include such technologies in the identification of IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT. Although emerging technologies may be seen to be more sophisticated or more complex compared to existing technologies, the auditor's responsibilities in relation to IT applications and identified general IT controls in accordance with paragraphs .28–.29 remain unchanged.

Scalability

6. Obtaining an understanding of the entity's IT environment may be more easily accomplished for a less complex entity that uses commercial software and when the entity does not have access to the source code to make any program changes. Such entities may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates to the IT applications. Specific matters that the auditor may consider in understanding the nature of a commercial accounting software package, which may be the single IT application used by a less complex entity in its information system, may include the following:

- The extent to which the software is well established and has a reputation for reliability.

- The extent to which it is possible for the entity to modify the source code of the software to include additional modules (that is, add-ons) to the base software or to make direct changes to data.
- The nature and extent of modifications that have been made to the software. Although an entity may not be able to modify the source code of the software, many software packages allow for configuration (for example, setting or amending reporting parameters). These do not usually involve modifications to source code; however, the auditor may consider the extent to which the entity is able to configure the software when considering the accuracy and completeness of information produced by the software that is used as audit evidence.
- The extent to which data related to the preparation of the financial statements can be directly accessed (that is, direct access to the database without using the IT application) and the volume of data that is processed. The greater the volume of data, the more likely the entity may need controls that address maintaining the integrity of the data, which may include general IT controls over unauthorized access and changes to the data.

7. Complex IT environments may include highly customized or highly integrated IT applications and, therefore, may require more effort to understand. Financial reporting processes or IT applications may be integrated with other IT applications. Such integration may involve IT applications that are used in the entity's business operations and that provide information to the IT applications relevant to the flows of transactions and information processing in the entity's information system. In such circumstances, certain IT applications used in the entity's business operations may also be relevant to the preparation of the financial statements. Complex IT environments also may require dedicated IT departments that have structured IT processes supported by personnel that have software development and IT environment maintenance skills. In other cases, an entity may use internal or external service providers to manage certain aspects of, or IT processes within, its IT environment (for example, third-party hosting).

Identifying IT Applications That Are Subject to Risks Arising From the Use of IT

8. Through understanding the nature and complexity of the entity's IT environment, including the nature and extent of information-processing controls, the auditor may determine which IT applications the entity is relying upon to accurately process and maintain the integrity of financial information. The identification of IT applications on which the entity relies, may affect the auditor's decision to test the automated controls within such IT applications, assuming that such automated controls address identified risks of material misstatement. Conversely, if the entity is not relying on an IT application, the automated controls within such IT application are unlikely to be appropriate or sufficiently precise for purposes of operating effectiveness tests. Automated controls that may be identified in accordance with paragraph .27 may include, for example, automated calculations or input and processing and output controls, such as a three-way match of a purchase order, vendor shipping document, and vendor invoice. When automated controls are identified by the auditor and the auditor determines through the understanding of the IT environment that the entity is relying on the IT application that includes those automated controls, it may be more likely for the auditor to identify the IT application as one that is subject to risks arising from the use of IT.

9. In considering whether the IT applications for which the auditor has identified automated controls are subject to risks arising from the use of IT, the auditor is likely to consider whether, and the extent to which, the entity may have access to source code that enables management to make program changes to such controls or the IT applications. The extent to which the entity makes program or configuration changes and the extent to which the IT processes over such changes are formalized may also be relevant considerations. The auditor is also likely to consider the risk of inappropriate access or changes to data.

10. System-generated reports that the auditor may intend to use as audit evidence may include, for example, a trade receivable aging report or an inventory valuation report. For such reports, the auditor may obtain audit evidence about the accuracy and completeness of the reports by performing audit procedures to test the inputs and outputs of the report-generating process. In other cases, the auditor may plan to test the operating effectiveness of the controls over the preparation and maintenance of the report, in which case, the IT application from which it is produced is likely to be subject to risks arising from the use of IT. In addition to testing the accuracy and completeness of the report, the auditor may plan to test the operating effectiveness of general IT controls that address risks related to inappropriate or unauthorized program changes to, or data changes in, the report.

11. Some IT applications may include report-writing functionality within them, whereas some entities may also use separate report-writing applications (that is, report writers). In such cases, the auditor may need to determine the sources of system-generated reports (that is, the application that prepares the report and the data sources used by the report) to determine the IT applications subject to risks arising from the use of IT.

12. The data sources used by IT applications may be databases that, for example, can be accessed only through the IT application or by IT personnel with database administration privileges. In other cases, the data source may be a data warehouse that may itself be considered to be an IT application subject to risks arising from the use of IT.

13. The auditor may have identified a risk for which substantive procedures alone are not sufficient because of the entity's use of highly automated and paperless processing of transactions, which may involve multiple integrated IT applications. In such circumstances, the controls identified by the auditor are likely to include automated controls. Further, the entity may be relying on general IT controls to maintain the integrity of the transactions processed and other information used in processing. In such cases, the IT applications involved in the processing and storage of the information are likely subject to risks arising from the use of IT.

End-User Computing

14. Although audit evidence may also come in the form of system-generated output that is used in a calculation performed in an end-user computing tool (for example, spreadsheet software or simple databases), such tools are not typically identified as IT applications in the context of paragraph .29. Designing and implementing controls around access and change to end-user computing tools may be challenging, and such controls are rarely equivalent to, or as effective as, general IT controls. Rather, the auditor may consider a combination of information-processing controls, taking into account the purpose and complexity of the end-user computing involved, such as some or all of the following:

- Information-processing controls over the initiation and processing of the source data, including relevant automated or interface controls to the point from which the data is extracted (for example, the data warehouse)
- Controls to check that the logic is functioning as intended, for example, controls that "prove" the extraction of data, such as reconciling the report to the data from which it was derived, comparing the individual data from the report to the source and vice versa, and controls that check the formulas or macros
- Use of validation software tools, which systematically check formulas or macros, such as spreadsheet integrity tools

Scalability

15. The entity's ability to maintain the integrity of information stored and processed in the information system may vary based on the complexity and volume of the related transactions and other information. The greater the complexity and volume of data that supports a significant class of transactions, account balance, or disclosure, the less likely it may become for the entity to maintain integrity of that information through information-processing controls alone (for example, input and output controls or review controls). It also becomes less likely that the auditor will be able to obtain audit evidence about the accuracy and completeness of such information through substantive procedures alone when such information is used as audit evidence. In some circumstances, when volume and complexity of transactions are lower, management may have an information-processing control that is sufficient to verify the accuracy and completeness of the data (for example, individual sales orders processed and billed may be reconciled to the hard copy originally entered into the IT application). When the entity relies on general IT controls to maintain the integrity of certain information used by IT applications, the auditor may determine that the IT applications that maintain that information are subject to risks arising from the use of IT.

<table>
<tr><th colspan="2">Considerations That May Assist in Determining Whether IT Applications Are Subject to Risks Arising From the Use of IT</th></tr>
<tr><td>Example characteristics of an IT application that are less likely subject to risks arising from the use of IT include the following:

• Stand-alone applications.
• The volume of data (transactions) is not significant.
• The application's functionality is not complex.
• Each transaction is supported by original hard copy documentation.</td><td>Example characteristics of an IT application that are more likely subject to risks arising from the use of IT include the following:

• Applications are interfaced.
• The volume of data (transactions) is significant.
• The application's functionality is complex because
— the application automatically initiates transactions, and
— there are a variety of complex calculations underlying automated entries.</td></tr>
<tr><td>IT application is likely not subject to risks arising from the use of IT because of the following:

• The volume of data is not significant, and management is not relying upon an application system to process or maintain the data.
• Management does not rely on automated controls or other automated functionality. The auditor has not identified automated controls in accordance with paragraph .27.
• Although management uses system-generated reports in its controls, it does not rely on the IT application to produce complete and accurate reports. Instead, it reconciles the reports back to the hard copy documentation and verify the calculations in the reports.
• The auditor will directly test information produced by the entity used as audit evidence.</td><td>IT application is likely subject to risks arising from the use of IT because of the following:

• Management relies on an application system to process or maintain data.
• Management relies upon the application system to perform certain automated controls that the auditor has also identified.</td></tr>
</table>

Other Aspects of the IT Environment That Are Subject to Risks Arising From the Use of IT

16. When the auditor identifies IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment are also typically subject to risks arising from the use of IT. The IT infrastructure includes databases, the operating system, and the network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. As such, IT applications and databases may be directly accessed through the operating system. A network is used in the IT infrastructure to transmit data and to share information, resources, and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources.

17. When IT applications are identified by the auditor to be subject to risks arising from the use of IT, the databases that store the data processed by an identified IT application are typically also identified. Similarly, because an IT application's ability to operate is often dependent on the operating system and IT applications, and databases may be directly accessed from the operating system, the operating system is typically subject to risks arising from the use of IT. The network may be identified when it is a central point of access to the identified IT applications and related databases, when an IT application interacts with vendors or external parties through the internet, or when web-facing IT applications are identified by the auditor.

Identifying Risks Arising From the Use of IT and General IT Controls

18. Examples of risks arising from the use of IT include risks related to inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both, as follows:

- Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or nonexistent transactions or inaccurate recording of transactions. Particular risks may arise when multiple users access a common database.
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorized changes to data in master files.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

19. The auditor's consideration of unauthorized access may include risks related to unauthorized access by internal or external parties. Such risks (for example, cybersecurity risks) may not necessarily affect financial reporting because an entity's IT environment may also include IT applications and related data that address operational or compliance needs. It is important to note that cyber incidents usually first occur through the perimeter and internal network layers, which tend to be further removed from the IT application, database, and operating systems that affect the preparation of the financial statements. Accordingly, if information about a security breach has been identified, the auditor ordinarily considers the extent to which such a breach had the potential to affect financial reporting. If financial reporting may be affected, the auditor may decide to understand and test the related controls to determine the possible impact or scope of potential misstatements in the financial statements or may determine that the entity has provided adequate disclosures in relation to such security breach.

20. In addition, laws and regulations that may have a direct or indirect effect on the entity's financial statements may include data protection legislation. Considering an entity's compliance with such laws or regulations, in accordance with section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, may involve understanding the entity's IT processes and general IT controls that the entity has implemented to address the relevant laws or regulations.

21. General IT controls are implemented to address risks arising from the use of IT. Accordingly, the auditor uses the understanding obtained about the identified IT applications and other aspects of the IT environment and the applicable risks arising from the use of IT in determining the general IT controls to identify. In some cases, an entity may use common IT processes across its IT environment or across certain IT applications, in which case, common risks arising from the use of IT and common general IT controls may be identified.

22. In general, a greater number of general IT controls related to IT applications and databases are likely to be identified than for other aspects of the IT environment. This is because these aspects are the most closely concerned with the information processing and storage of information in the entity's information system. In identifying general IT controls, the auditor may consider controls over actions of both end users and of the entity's IT personnel or IT service providers.

23. Appendix F, "Considerations for Understanding General IT Controls," provides further explanation of the nature of the general IT controls that may be implemented for different aspects of the IT environment.

Appendix F — Considerations for Understanding General IT Controls (Ref: par. .29 and .A190–.A200)

.A279

This appendix provides further explanation of the nature of the general IT controls that may be implemented for different aspects of the IT environment.

1. The nature of the general IT controls that may be implemented for different aspects of the IT environment include the following:

a. *Applications*. General IT controls at the IT application layer will correlate to the nature and extent of application functionality and the access paths allowed in the technology. For example, different controls may be identified for highly integrated IT applications with complex security options than for an IT application supporting account balances with access methods only through transactions.

b. *Database*. General IT controls at the database layer typically address risks arising from the use of IT related to unauthorized updates to financial reporting information in the database through direct database access or execution of a script or program.

c. *Operating system*. General IT controls at the operating system layer typically address risks arising from the use of IT related to administrative access, which can facilitate the override of other controls. This includes actions such as compromising other user's credentials; adding new, unauthorized users; installing software that is not adequately tested, software containing an issue not yet fixed, or malware; or executing scripts or other unauthorized programs.

d. *Network*. General IT controls at the network layer typically address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls may be relevant when the entity has significant business partner relationships or third-party outsourcing, which may increase data transmissions and the need for remote access.

2. Examples of general IT controls that may exist, organized by IT process, include the following:

a. Process to manage access:

   i. *Authentication*. Controls that validate that a user accessing the IT application or other aspect of the IT environment is using the user's own log-in credentials (that is, the user is not using another user's credentials).

   ii. *Authorization*. Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties.

iii. *Provisioning*. Controls to authorize new users and modifications to existing users' access privileges.

iv. *Deprovisioning*. Controls to remove user access upon termination or transfer.

v. *Privileged access.* Controls over administrative or powerful users' access.

vi. *User-access reviews*. Controls to recertify or evaluate user access for ongoing authorization over time.

vii. *Security configuration controls*. Each technology generally has key configuration settings that help restrict access to the environment.

viii. *Physical access*. Controls over physical access to the data center and hardware because such access may be used to override other controls.

b. Process to manage program or other changes to the IT environment:

i. *Change-management process.* Controls over the process to design, program, test, and migrate changes to a production (that is, end user) environment.

ii. *Segregation of duties over change migration*. Controls that segregate access to make and migrate changes to a production environment.

iii. *Systems development or acquisition or implementation.* Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment).

iv. *Data conversion*. Controls over the conversion of data during development, implementation, or upgrades to the IT environment.

c. Process to manage IT operations:

i. *Job scheduling.* Controls over access to schedule and initiate jobs or programs that may affect financial reporting.

ii. *Job monitoring.* Controls to monitor financial reporting jobs or programs for successful execution.

iii. *Backup and recovery.* Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack.

iv. *Intrusion detection.* Controls to monitor for vulnerabilities or intrusions in the IT environment.

3. General IT controls need not be identified for every IT process. General IT controls are identified based on the risks arising from the use of IT. See paragraph 15 of appendix E, "Considerations for Understanding IT," for examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

AU-C Section 320

Materiality in Planning and Performing an Audit

Source: SAS No. 122; SAS No. 134; SAS No. 138.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. Section 450, *Evaluation of Misstatements Identified During the Audit*, explains how materiality is applied in evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements.

Materiality in the Context of an Audit

.02 Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and fair presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.
- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.
- judgments about materiality involve both qualitative and quantitative considerations.
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.03 Such a discussion about materiality provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .02 provide the auditor with such a frame of reference.

.04 The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements. For purposes of determining materiality, the auditor may assume that reasonable users

a. have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

b. understand that financial statements are prepared, presented, and audited to levels of materiality;

c. recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and

d. make reasonable judgments based on the information in the financial statements.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.05 The concept of materiality is applied by the auditor both in planning and performing the audit; evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements; and in forming the opinion in the auditor's report. (Ref: par. .A2)

.06 In planning the audit, the auditor makes judgments about misstatements that will be considered material. These judgments provide a basis for

a. determining the nature and extent of risk assessment procedures;

b. identifying and assessing the risks of material misstatement; and

c. determining the nature, timing, and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. It is not practicable to design audit procedures to detect all misstatements that could be material solely because of their nature (that is, qualitative considerations). However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement.[1] In addition, when evaluating the effect on the financial statements of all uncorrected misstatements, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence.[2] (Ref: par. .A1) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Effective Date

.07 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.08 The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.

Definition

.09 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

Performance materiality. The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. (Ref: par. .A3)

[1]See paragraphs .A141–.A142 of section 315A, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[2]Paragraph .A23 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

Requirements

Determining Materiality and Performance Materiality When Planning the Audit

.10 When establishing the overall audit strategy, the auditor should determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, one or more particular classes of transactions, account balances, or disclosures exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements, the auditor also should determine the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures. (Ref: par. .A4–.A14) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.11 The auditor should determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing, and extent of further audit procedures. (Ref: par. .A15)

Revision as the Audit Progresses

.12 The auditor should revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. (Ref: par. .A16–.A17)

.13 If the auditor concludes that a lower materiality than that initially determined for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) is appropriate, the auditor should determine whether it is necessary to revise performance materiality and whether the nature, timing, and extent of the further audit procedures remain appropriate.

Documentation

.14 The auditor should include in the audit documentation the following amounts and the factors considered in their determination:[3]

a. Materiality for the financial statements as a whole (see paragraph .10)

b. If applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures (see paragraph .10)

c. Performance materiality (see paragraph .11)

[3]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

d. Any revision of (*a*)–(*c*) as the audit progressed (see paragraphs .12–.13)

Application and Other Explanatory Material

Materiality in the Context of an Audit (Ref: par. .06)

.A1 Identifying and assessing the risks of material misstatement[4] involves the use of professional judgment to identify those classes of transactions, account balances, and disclosures, including qualitative disclosures, the misstatement of which could be material (in general, misstatements are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as the following:

- The circumstances of the entity for the period (For example, the entity may have undertaken a significant business combination during the period.)
- The applicable financial reporting framework, including changes therein (For example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity.)
- Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (For example, liquidity risk disclosures may be important to users of the financial statements for a financial institution.)

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Revised, April 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

Materiality and Audit Risk (Ref: par. .05)

.A2 In conducting an audit of financial statements, the overall objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and to report on the financial statements and communicate, as required by GAAS, in accordance with the auditor's findings.[5] The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.[6]*Audit risk* is

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[4]Paragraph .26 of section 315A requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion levels. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[5]Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[6]Paragraph .19 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.[7] Materiality and audit risk are considered throughout the audit, in particular, when

a. determining the nature and extent of risk assessment procedures to be performed;

b. identifying and assessing the risks of material misstatement;[8]

c. determining the nature, timing, and extent of further audit procedures;[9] and

d. evaluating the effect of uncorrected misstatements, if any, on the financial statements[10] and in forming the opinion in the auditor's report.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Definition (Ref: par. .09)

.A3 *Tolerable misstatement* is the application of performance materiality to a particular sampling procedure. Section 530, *Audit Sampling*, defines *tolerable misstatement* and provides further application guidance about the concept.[11] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Determining Materiality and Performance Materiality When Planning the Audit

Considerations Specific to Governmental Entities (Ref: par. .10)

.A4 In the case of a governmental entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions. The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) in an audit of the financial statements of a governmental entity, therefore, may be influenced by law or regulation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A5 For most state or local governments, a governmental entity's applicable financial reporting framework is based on multiple reporting units, and generally, the auditor expresses or disclaims an opinion on a government's financial statements as a whole by providing opinions or disclaimers of opinion on each opinion unit. That is, a state or local

[7]Paragraph .14 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[8]See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[9]See section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[10]Paragraph .11 of section 450. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[11]Paragraph .A6 of section 530, *Audit Sampling*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

governmental entity's applicable financial reporting framework requires the presentation of financial statements for its varied activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. Accordingly, in these cases, materiality is established for each opinion unit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole (Ref: par. .10)

.A6 Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, or expenses)
- Whether items exist on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue, or net assets)
- The nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings)
- The relative volatility of the benchmark

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A7 Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income, such as profit before tax, total revenue, gross profit, and total expenses; total equity; or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A8 With regard to the chosen benchmark, relevant financial data ordinarily includes prior periods' financial results and financial positions; the period-to-date financial results and financial position, budgets, or forecasts for the current period, adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition); and relevant changes of conditions in the industry or economic environment in which the entity operates. For example, when, as a starting point, materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure based on past results. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A9 Materiality relates to the financial statements that are being audited. When the financial statements are prepared for a financial reporting period of more or less than 12 months, such as may be the case for a new entity or a change in the financial reporting period, materiality relates to the financial statements prepared for that financial reporting period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A10 Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. A relationship exists between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue. For example, the auditor may consider a percentage of profit before tax from continuing operations to be appropriate for a profit-oriented entity in a manufacturing industry. Chapter 3 of the AICPA Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* provides further guidance about the use of benchmarks in determining materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A11 When an entity's profit before tax from continuing operations is consistently nominal, which might be the case for an owner-managed business in which the owner takes much of the profit before tax in the form of remuneration, a benchmark such as profit before remuneration and tax may be more relevant. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities

.A12 In an audit of a governmental entity, total cost or net cost (expenses less revenues or expenditures less receipts) may be appropriate benchmarks for program activities. When a governmental entity has custody of public assets, assets may be an appropriate benchmark. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)

.A13 Factors that may indicate the existence of one or more particular classes of transactions, account balances, or disclosures for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements include the following:

- Whether law, regulation, or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions and the remuneration of management and those charged with governance, and sensitivity analysis for fair value accounting estimates with high estimation uncertainty)

- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, disclosures about discontinued operations or a significant business combination)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A14 In considering whether, in the specific circumstances of the entity, such classes of transactions, account balances, or disclosures exist, the auditor may find it useful to obtain an understanding of the views and expectations of those charged with governance and management. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Performance Materiality (Ref: par. .11)

.A15 Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. *Performance materiality* (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance, or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance, or disclosure exceeds the materiality level for that particular class of transactions, account balance, or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Revision as the Audit Progresses (Ref: par. .12)

.A16 In some situations, the auditor may determine materiality for planning purposes before the financial statements to be audited are prepared. In those situations, the auditor's professional judgment about materiality might be based on the entity's annualized interim financial statements or financial statements of one or more prior annual periods. If it appears as though the actual financial results are likely to be substantially different from the anticipated results, such as when there are major changes in the entity's circumstances (for example, a significant merger) or relevant changes in the economy as a whole or the industry in which the entity operates, the auditor may be required, in accordance with paragraph .12, to revise materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A17 Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures. For example, if, during the audit, it appears as though actual financial results are likely to be substantially different from the anticipated period-end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor may be required, in accordance with paragraph .12, to revise materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

AU-C Section 330

Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 142; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and to evaluate the audit evidence obtained in an audit of financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the auditor's responsibility to form an opinion on the financial statements based on the evaluation of the audit evidence obtained. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks.

Definitions

.04 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Substantive procedure. An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise

a. tests of details (classes of transactions, account balances, and disclosures) and

b. substantive analytical procedures.

Test of controls. An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Requirements

Overall Responses

.05 The auditor should design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: par. .A1–.A3)

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

.06 The auditor should design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. When evaluating audit evidence with respect to the assessed risks of material misstatement, the auditor maintains professional skepticism, including when considering information that may be used as audit evidence and what procedures would be appropriate in the circumstances. (Ref: par. .A4–.A9) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

.07 In designing the further audit procedures to be performed, the auditor should

a. consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each significant class of transactions, account balance, and disclosure, including

  i. the likelihood and magnitude of misstatement due to the particular characteristics of the significant class of transactions, account balance, or disclosure (the inherent risk) and

  ii. whether the risk assessment takes account of controls that address the risk of material misstatement (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor plans to test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures), and (Ref: par. .A10–.A19)

b. obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: par. .A20)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Tests of Controls

.08 The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of controls if

a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively (that is, the auditor plans to test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures) or

b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. (Ref: par. .A21–.A26)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.09 In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: par. .A27)

Nature and Extent of Tests of Controls

.10 In designing and performing tests of controls, the auditor should

a. perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including

   i. how the controls were applied at relevant times during the period under audit;

   ii. the consistency with which they were applied; and

   iii. by whom or by what means they were applied, including, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively, and (Ref: par. .A28–.A34)

b. to the extent not already addressed, determine whether the controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain audit evidence supporting the operating effectiveness of those indirect controls. (Ref: par. .A35)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Timing of Tests of Controls

.11 The auditor should test controls for the particular time or throughout the period for which the auditor intends to rely on those controls, subject to paragraphs .12 and .15 that follow, in order to provide an appropriate basis for the auditor's intended reliance. (Ref: par. .A35)

Using Audit Evidence Obtained During an Interim Period

.12 If the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor should

a. obtain audit evidence about significant changes to those controls subsequent to the interim period and

b. determine the additional audit evidence to be obtained for the remaining period. (Ref: par. .A36–.A37)

Using Audit Evidence Obtained in Previous Audits

.13 In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits and, if so, the length of the time period that may elapse before retesting a control, the auditor should consider

a. the effectiveness of other components of the entity's system of internal control, including the control environment, the entity's process to monitor the system of internal control, and the entity's risk assessment process;

b. the risks arising from the characteristics of the control, including whether the control is manual or automated;

c. the effectiveness of general IT controls;

d. the effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits and whether there have been personnel changes that significantly affect the application of the control;

e. whether the lack of a change in a particular control poses a risk due to changing circumstances; and

f. the risks of material misstatement and the extent of reliance on the control. (Ref: par. .A38)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.14 If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor should perform audit procedures to establish the continuing relevance of that information to the current audit. The auditor should obtain this evidence by performing inquiry, combined with observation or inspection, to confirm the understanding of those specific controls, and

a. if there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor should test the controls in the current audit. (Ref: par. .A39)

b. if there have not been such changes, the auditor should test the controls at least once in every third audit and should test some controls during each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: par. .A40–.A42)

Controls Over Significant Risks

.15 If the auditor intends to rely on controls over a risk the auditor has determined to be a significant risk,[1] the auditor should test the operating effectiveness of those controls in the current period. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Evaluating the Operating Effectiveness of Controls

.16 When evaluating the operating effectiveness of controls upon which the auditor intends to rely, the auditor should evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the relevant assertion being tested are effective. (Ref: par. .A43) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.17 If deviations from controls upon which the auditor intends to rely are detected, the auditor should make specific inquiries to understand these matters and their potential consequences and should determine whether

a. the tests of controls that have been performed provide an appropriate basis for reliance on the controls,

b. additional tests of controls are necessary, or

c. the risks of material misstatement need to be addressed using substantive procedures. (Ref: par. .A44)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[1]Paragraphs .28–.30 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Substantive Procedures

.18 The auditor should perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure, regardless of the assessed level of control risk.. (Ref: par. .A45–.A50) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.19 The auditor should consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: par. .A51–.A56)

.20 The auditor should use external confirmation procedures for accounts receivable, except when one or more of the following is applicable: (Ref: par. .A55)

a. The overall account balance is immaterial.

b. External confirmation procedures for accounts receivable would be ineffective. (Ref: par. .A54 and .A56)

c. The auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. In many situations, the use of external confirmation procedures for accounts receivable and the performance of other substantive procedures are necessary to reduce the assessed risk of material misstatement to an acceptably low level.

Substantive Procedures Related to the Financial Statement Closing Process

.21 The auditor's substantive procedures should include audit procedures related to the financial statement closing process, such as

a. agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers, and

b. examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: par. .A57)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Substantive Procedures Responsive to Significant Risks

.22 If the auditor has determined that an assessed risk of material misstatement at the relevant assertion level is a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details. (Ref: par. .A58–.A59)

Timing of Substantive Procedures

.23 If substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing

a. substantive procedures, combined with tests of controls for the intervening period, or

b. if the auditor determines that it is sufficient, further substantive procedures only,

that provide a reasonable basis for extending the audit conclusions from the interim date to the period-end. (Ref: par. .A60–.A64)

.24 If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor should evaluate whether the related assessment of risk and the planned nature, timing, or extent of substantive procedures covering the remaining period need to be modified. See section 240, *Consideration of Fraud in a Financial Statement Audit*.[2] (Ref: par. .A65)

Selecting Items for Testing to Obtain Audit Evidence

.25 When designing tests of controls and tests of details, the auditor should determine the means of selecting items for testing that are effective in meeting the purpose of the audit procedure. (Ref: par. .A66–.A72)

Adequacy of Presentation of the Financial Statements

.26 The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor should consider whether the financial statements are presented in a manner that reflects the following:

a. The appropriate classification and description of financial information and the underlying transactions, events, and conditions

b. The appropriate presentation, structure, and content of the financial statements (Ref: par. .A73)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence[3]

.27 Based on the audit procedures performed and the audit evidence obtained, the auditor should evaluate, before the conclusion of the audit, whether the assessments of the risks of material misstatement at the relevant assertion level remain appropriate. (Ref: par. .A74–.A76)

[2] Paragraphs .35–.36 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

[3] See section 700, *Forming an Opinion and Reporting on Financial Statements*.

.28 The auditor should conclude whether sufficient appropriate audit evidence has been obtained. In forming a conclusion, the auditor should consider all audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements. (Ref: par. .A77) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

.29 If the auditor has not obtained sufficient appropriate audit evidence related to a relevant assertion about a significant class of transactions, account balance, or disclosure, the auditor should attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should express a qualified opinion or disclaim an opinion on the financial statements.[4] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Documentation

.30 The auditor should include in the audit documentation[5]

a. the overall responses to address the assessed risks of material misstatement at the financial statement level and the nature, timing, and extent of the further audit procedures performed;

b. the linkage of those procedures with the assessed risks at the relevant assertion level; and

c. the results of the audit procedures, including the conclusions when such conclusions are not otherwise clear. (Ref: par. .A78)

.31 If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor should include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

.32 The auditor should include in the audit documentation the basis for any determination not to use external confirmation procedures for accounts receivable when the account balance is material.

.33 The auditor's documentation should demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

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[4] Paragraphs .08–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, address qualified, adverse, and disclaimer of opinions.

[5] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Application and Other Explanatory Material

Overall Responses (Ref: par. .05)

.A1 Overall responses to address the assessed risks of material misstatement at the financial statement level may include[6]

- emphasizing to the audit team the need to maintain professional skepticism.
- assigning more experienced staff or those with specialized skills or using specialists.
- providing changes to the nature, timing, and extent of direction and supervision of members of the engagement team and the review of the work performed.
- incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- changes to the overall audit strategy as required by section 300, Planning an Audit, or planned audit procedures, and may include changes to the following:
  - — The auditor's determination of performance materiality in accordance with section 320.
  - — The auditor's plans to test the operating effectiveness of controls, and the persuasiveness of audit evidence needed to support the planned reliance on the operating effectiveness of the controls, particularly when control deficiencies in the control environment or the entity's monitoring activities are identified.
  - — The nature, timing, and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial statements when the risk of material misstatement is assessed as higher.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A2 The assessment of the risks of material misstatement at the financial statement level and, thereby, the auditor's overall responses are affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and, thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period-end. Deficiencies in the control environment, however, have the opposite effect (for example, the auditor may respond to an ineffective control environment by

- conducting more audit procedures as of the period-end rather than at an interim date,
- obtaining more extensive audit evidence from substantive procedures, and

[6]Paragraphs .07–.08 of section 300, *Planning an Audit*, address the auditor's overall audit strategy.

- increasing the number of locations to be included in the audit scope).

.A3 Such considerations, therefore, have a significant bearing on the auditor's general approach (for example, an emphasis on substantive procedures [substantive approach] or an approach that uses tests of controls as well as substantive procedures [combined approach]).

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

The Nature, Timing, and Extent of Further Audit Procedures (Ref: par. .06)

.A4 The auditor's assessment of the identified risks of material misstatement at the relevant assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that

a. in addition to the substantive procedures that are required for all relevant assertions, in accordance with paragraph .18, an effective response to the assessed risk of material misstatement for a particular assertion can be achieved only by also performing tests of controls.

b. performing only substantive procedures is appropriate for particular assertions, and therefore, the auditor excludes the effect of controls from the assessment of the risk of material misstatement. This may be because the auditor has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence and, as a result, is not required to test the operating effectiveness of controls. Therefore, the auditor may not plan to test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures.

c. a combined approach using both tests of controls and substantive procedures is an effective approach.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A5 The nature of an audit procedure refers to its purpose (test of controls or substantive procedure) and its type (inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure). See section 500, *Audit Evidence*, which provides further application guidance about audit procedures.[7] The nature of the audit procedures is most important in responding to the assessed risks.

.A6 Timing of an audit procedure refers to when it is performed or the period or date to which the audit evidence applies.

.A7 Extent of an audit procedure refers to the quantity to be performed (for example, a sample size or the number of observations of a control). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[7]Paragraphs .A10–.A26 of section 500, *Audit Evidence*.

.A8 Designing and performing further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level provides a clear linkage between the auditor's further audit procedures and the risk assessment.

.A9 Because effective internal controls generally reduce but do not eliminate the risk of material misstatement, tests of controls reduce but do not eliminate the need for substantive procedures. In addition, analytical procedures alone may not be sufficient in some cases. For example, when auditing certain estimation processes, such as the allowance for doubtful accounts, the auditor may perform substantive procedures beyond analytical procedures (for example, examining cash collections subsequent to the period-end) due to the risk of management override of controls[8] or the subjectivity of the account balance.

Responding to the Assessed Risks at the Assertion Level (Ref: par. .07a)

.A10 *Nature.* Section 315 requires that the auditor's assessment of the risks of material misstatement at the assertion level is performed by assessing inherent risk and control risk. The auditor assesses inherent risk by assessing the likelihood and magnitude of a misstatement, taking into account how and the degree to which the inherent risk factors affect the susceptibility of assertions to misstatement.[9] The auditor's assessed risks, including the reasons for those assessed risks, may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, regarding revenue, tests of controls may be most responsive to the assessed risk of material misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of material misstatement of the occurrence assertion. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A11 The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because the auditor plans to test the operating effectiveness of controls that are appropriately designed and implemented and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph .08*a*. This may be the case, for example, for a class of transactions of reasonably uniform, noncomplex characteristics that are routinely processed and controlled by the entity's information system. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[8]The auditor is required by paragraphs .31–.33 of section 240 to perform audit procedures responsive to risks related to management override of controls.

[9]Paragraph .48 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A12 *Timing.* The auditor may perform tests of controls or substantive procedures at an interim date or at the period-end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to or at the period-end rather than at an earlier date or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from the interim date to the period-end would not be effective.

.A13 On the other hand, performing audit procedures before the period-end may assist the auditor in identifying significant issues at an early stage of the audit and consequently resolving them with the assistance of management or developing an effective audit approach to address such issues.

.A14 In addition, certain audit procedures can be performed only at or after the period-end, for example,

- agreeing or reconciling information in the financial statements, including classes of transactions, account balances, and disclosures, with the underlying accounting records including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers;
- examining adjustments made during the course of preparing the financial statements; and
- procedures to respond to a risk that at the period-end the entity may have entered into improper sales contracts or transactions may not have been finalized.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A15 Further relevant factors that influence the auditor's consideration of when to perform audit procedures include

- the effectiveness of the control environment.
- when relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- the nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may examine contracts available on the date of the period-end).
- the period or date to which the audit evidence relates.
- the timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the financial statements.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A16 *Extent.* The extent of an audit procedure judged necessary is determined after considering the materiality, assessed risk, and degree of assurance the auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure may be considered separately. In general, the extent of audit procedures increases as the risks of material misstatement increase. For example, in response to the assessed risks of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

.A17 The use of computer assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing (for example, in responding to the risks of material misstatement due to fraud). Such techniques can be used to select sample transactions from key electronic files, sort transactions with specific characteristics, or test an entire population instead of a sample.

.A18 *Considerations specific to governmental entities.* For the audits of governmental entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing, and extent of further audit procedures. For example, under some governmental audit requirements, the auditor is required to perform tests of controls, even if reliance is not planned.

.A19 *Considerations specific to smaller, less complex entities.* In the case of smaller entities, the auditor may not identify controls, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of controls or components of the system of internal control may make it impossible to obtain sufficient appropriate audit evidence. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Higher Assessments of Risk (Ref: par. .07b)

.A20 When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable (for example by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources).

Tests of Controls

Designing and Performing Tests of Controls (Ref: par. .08)

.A21 Tests of controls are performed only on those controls that the auditor plans to test and has determined are suitably designed to prevent, or detect and correct, a material misstatement in a relevant assertion. If substantially different controls were used at different times during the period under audit, each is considered separately. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time the auditor is evaluating their design and determining that they have been implemented.

.A23 Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included the following:

- Inquiring about management's use of budgets
- Observing management's comparison of monthly budgeted and actual expenses
- Inspecting reports pertaining to the investigation of variances between budgeted and actual amounts

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented but also may provide audit evidence about the effectiveness of the operation of budgeting policies in preventing, or detecting and correcting, material misstatements in the classification of expenses.

.A24 In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, which also is known as a dual purpose test. For example, the auditor may design and evaluate the results of a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual purpose test is designed and evaluated by considering each purpose of the test separately.

.A25 In some cases, the auditor may find it impossible to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the relevant assertion level.[10] This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph .08*b* requires the auditor to perform tests of controls that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A26 The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive

[10] Paragraph .31 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

analytical procedures in response to assessed risks. See section 520, *Analytical Procedures*, for further guidance.[11]

Audit Evidence and Intended Reliance (Ref: par. .09)

.A27 A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular when it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

.A28 *Other audit procedures in combination with inquiry (Ref: par. .10*a*).* Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection, recalculation, or reperformance may provide more assurance than inquiry and observation because an observation is pertinent only at the point in time at which it is made.

.A29 The nature of the particular control influences the type of audit procedure necessary to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect such documentation to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of controls, such as automated controls. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures, such as observation or the use of CAATs. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A30 In some situations, particularly in smaller, less complex entities, an entity might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for an entity's financial reporting and associated controls, the auditor may take into account the combined competence of entity personnel and other parties that assist with functions related to financial reporting.

.A31 *Extent of tests of controls.* When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. In addition to the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period

[11]Paragraph .A19 of section 520, *Analytical Procedures*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control
- The expected rate of deviation from a control
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the relevant assertion level
- The extent to which audit evidence is obtained from tests of other controls related to the relevant assertion

However, the rate of expected deviation may indicate that obtaining audit evidence from the performance of tests of controls will not be sufficient to reduce the control risk at the relevant assertion level. If the rate of expected deviation is expected to be high, tests of controls for a particular assertion may not provide sufficient appropriate audit evidence. Section 530, *Audit Sampling*, contains further guidance on the extent of testing.

.A32 Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the IT application (including the tables, files, or other permanent data used by the IT application) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests may include testing the general IT controls related to the IT application. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A33 Similarly, the auditor may perform tests of controls that address risks of material misstatement related to the integrity of the entity's data, or the accuracy and completeness of the entity's system-generated reports, or may determine they are necessary to address risks of material misstatement because substantive procedures alone cannot provide sufficient appropriate audit evidence. These tests of controls may include tests of general IT controls that address the matters in paragraph .10*a*. When this is the case, the auditor may not need to perform any further testing to obtain audit evidence about the matters in paragraph .10*a*. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A34 When the auditor determines that a general IT control is deficient, the auditor may consider the nature of the related risks arising from the use of IT that were identified in accordance with SAS No. 145[12] to provide the basis for the design of the auditor's additional procedures to address the assessed risk of material misstatement. Such procedures may address determining the following:

- Whether the related risks arising from the use of IT have occurred. For example, if users have unauthorized access to an IT application (but cannot access or modify the

[12]Paragraph .41 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

system logs that track access), the auditor may decide to inspect the system logs to obtain audit evidence that those users did not access the IT application during the period.

- Whether there are any alternate or redundant general IT controls, or any other controls, that address the related risks arising from the use of IT. If so, the auditor may identify such controls (if not already identified) and, therefore, evaluate their design, determine that they have been implemented, and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end-user access reports on a timely basis. Circumstances in which an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (for example, a bank statement) or internal sources not affected by the general IT control deficiency (for example, a separate IT application or data source).

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A35 *Testing of indirect controls (Ref: par. .10*b*).* In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (for example, general IT controls). As explained in paragraphs .A33–.A34, general IT controls may have been identified in accordance with section 315 because of their support of the operating effectiveness of automated controls or due to their support in maintaining the integrity of information used in the entity's financial reporting, including system-generated reports. The requirement in paragraph .10*b* acknowledges that the auditor may have already tested certain indirect controls to address the matters in paragraph .10*a*. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[.A36] [Paragraph renumbered and deleted by the issuance of SAS No. 145, October 2021.]

Timing of Tests of Controls

.A37 *Intended period of reliance (Ref: par. .11).* Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose (for example, when testing controls over the entity's physical inventory counting at the period-end). If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of controls in the entity's process to monitor the system of internal controls. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A38 *Using audit evidence obtained during an interim period (Ref: par. .12).* Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include the following:

- The significance of the assessed risks of material misstatement at the relevant assertion level
- The specific controls that were tested during the interim period and the results of those tests
- Significant changes to the controls since they were tested, including changes in the information system, processes, and personnel
- The degree to which audit evidence about the operating effectiveness of those controls was obtained
- The length of the remaining period
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls
- The effectiveness of the control environment

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A39 Additional audit evidence may be obtained, for example, by extending the testing of the operating effectiveness of controls over the remaining period or testing the entity's monitoring of controls. [Paragraph renumbered by the issuance of SAS No. 145,October 2021.]

.A40 *Using audit evidence obtained in previous audits (Ref: par. .13).* In certain circumstances, audit evidence obtained from previous audits may provide audit evidence, provided that the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit and its reliability. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A41 *Controls that have changed from previous audits (Ref: par. .14*a*).* Changes may affect the relevance and reliability of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A42 *Controls that have not changed from previous audits (Ref: par. .14*b*).* The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that

- have not changed since they were last tested and
- are not controls that mitigate a significant risk

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment but is required by paragraph .14*b* to be at least once in every third audit. (This guidance may not be appropriate for audits not performed at least on an annual basis.) [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A43 In general, the higher the risk of material misstatement or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control or result in not relying on audit evidence obtained in previous audits at all include the following:

- A deficient control environment
- A control deficiency in the entity's process to monitor the system of internal control
- A significant manual element to the identified controls
- Personnel changes that significantly affect the application of the control
- Changing circumstances that indicate the need for changes in the control
- Deficient general IT controls

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A44 When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Evaluating the Operating Effectiveness of Controls (Ref: par. .16–.17)

.A45 In accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*, the identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control is an indicator of a material weakness.[13] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A46 The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from

[13]Paragraph .A11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions, and human error. The detected rate of deviation, in particular, in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the relevant assertion level to that assessed by the auditor. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Substantive Procedures (Ref: par. .18)

.A47 Paragraph .18 requires the auditor to design and perform substantive procedures for all relevant assertions related to each significant class of transactions, account balance, and disclosure. For such classes of transactions, account balances, and disclosures, substantive procedures may have already been performed because paragraph .06 requires the auditor to design and perform further audit procedures that are responsive to the assessed risks of material misstatement at the relevant assertion level. Accordingly, substantive procedures are required to be designed and performed in accordance with paragraph .18 when the further audit procedures designed and performed in accordance with paragraph .06 for significant classes of transactions, account balances, or disclosures, designed and performed in accordance with paragraph .06, did not include substantive procedures. This requirement reflects the facts that (i) the auditor's assessment of risk is judgmental and may not identify all risks of material misstatement and (ii) inherent limitations to internal control exist, including management override. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]requires the auditor to design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that (i) the auditor's assessment of risk is judgmental and may not identify all risks of material misstatement and (ii) inherent limitations to internal control exist, including management override. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Nature and Extent of Substantive Procedures

.A48 Depending on the circumstances, the auditor may determine the following:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level, such as, for example, when the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A49 Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Section 520 addresses the application of analytical procedures during an audit. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A50 The assessment of the risk or the nature of the nature of the assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. For example, the auditor might inspect subsequent cash disbursements and compare them with the recorded accounts payable to determine whether any purchases had been omitted from accounts payable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A51 Because the assessment of the risks of material misstatement takes account of controls which the auditor plans to test, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A52 In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters also are relevant, including whether it is more effective to use other selective means of testing. See paragraphs .A66–.A72. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: par. .19–.20)

.A53 External confirmation procedures frequently may be relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations in which external confirmation procedures may provide audit evidence in responding to assessed risks of material misstatement include the following:

- Bank balances and other information relevant to banking relationships
- Inventories held by third parties at bonded warehouses for processing or on consignment
- Property title deeds held by lawyers or financiers for safe custody or as security
- Investments held for safekeeping by third parties or purchased from stockbrokers but not delivered at the balance sheet date

- Amounts due to lenders, including relevant terms of repayment and restrictive covenants
- Accounts payable balances and terms

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A54 Although external confirmations may provide audit evidence relating to certain assertions, some assertions exist for which external confirmations provide less persuasive audit evidence, for example, external confirmations provide less persuasive audit evidence relating to the recoverability of accounts receivable balances than they do of their existence. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A55 The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A56 Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include the following:

- The confirming party's knowledge of the subject matter. Responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond. For example, the confirming party
  - — may not accept responsibility for responding to a confirmation request,
  - — may consider responding too costly or time consuming,
  - — may have concerns about the potential legal liability resulting from responding,
  - — may account for transactions in different currencies, or
  - — may operate in an environment in which responding to confirmation requests is not a significant aspect of day-to-day operations.

  In such situations, confirming parties may not respond, may respond in a casual manner, or may attempt to restrict the reliance placed on the response.
- The objectivity of the intended confirming party. If the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A57 For purposes of this section, *accounts receivable* means

a. the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business; and

b. a financial institution's loans.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A58 External confirmation procedures may be ineffective when, based on prior years' audit experience or experience with similar entities

- response rates to properly designed confirmation requests will be inadequate; or
- responses are known or expected to be unreliable.

If the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may instead consider changing the manner in which the confirmation process is performed, with the objective of increasing the response rates, or may consider obtaining audit evidence from other sources. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Substantive Procedures Related to the Financial Statement Closing Process (Ref: par. .21b)

.A59 The nature and also the extent of the auditor's substantive procedures related to the financial statement closing process, including testing the appropriateness of journal entries and other adjustments, depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Substantive Procedures Responsive to Significant Risks (Ref: par. .22)

.A60 Paragraph .22 requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Because significant unusual transactions can affect the risks of material misstatement due to error or fraud, substantive procedures that take into account the types of potential misstatements that could result from significant unusual transactions may be necessary, including procedures performed pursuant to paragraph .32 of section 240. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A61 Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, a risk may exist that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Timing of Substantive Procedures (Ref: par. .23–.24)

.A62 In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. However, exceptions exist (for example, a legal opinion obtained in a previous audit related to the structure of a securitization to which no changes have occurred may be relevant in the current period). In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed and audit procedures have been performed during the current period to establish its continuing relevance. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A63 *Using audit evidence obtained during an interim period (Ref: par. .23).* In some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date and compare and reconcile information concerning the balance at the period-end with the comparable information at the interim date to

a. identify amounts that appear unusual,

b. investigate any such amounts, and

c. perform substantive analytical procedures or tests of details to test the intervening period.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A64 Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period-end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The effectiveness of the control environment and other controls
- The availability at a later date of information necessary for the auditor's procedures
- The purpose of the substantive procedure
- The assessed risk of material misstatement

- The nature of the class of transactions or account balance and relevant assertions
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period-end will not be detected

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A65 In circumstances in which the auditor has identified risks of material misstatement due to fraud, the auditor's responses to address those risks may include changing the timing of audit procedures. For example, the auditor might conclude that, given the risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period-end reporting date would not be effective. In such circumstances, the auditor might conclude that substantive procedures performed at or near the end of the reporting period best address an identified risk of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A66 Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period-end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition
- Whether the entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and establishing proper accounting cutoffs are appropriate
- Whether the information system will provide information concerning the balances at the period-end and the transactions in the remaining period that is sufficient to permit investigation of the following:
  - — Significant unusual transactions or entries (including those at or near the period-end)
  - — Other causes of significant fluctuations or expected fluctuations that did not occur
  - — Changes in the composition of the classes of transactions or account balances

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A67 *Misstatements detected at an interim date (Ref: par. .24).* When the auditor concludes that the planned nature, timing, or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating, at the period-end, the procedures performed at the interim date. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Selecting Items for Testing to Obtain Audit Evidence (Ref: par. .25)

.A68 An effective test provides appropriate audit evidence to the extent that it will be sufficient for the auditor's purpose when taken with other audit evidence obtained or to be obtained. In selecting items for testing, the auditor is required by section 500 to consider the relevance and reliability of information to be used as audit evidence;[14] the other aspect of effectiveness (extent) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are

a. selecting all items (100 percent examination),

b. selecting specific items, and

c. audit sampling.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A69 The application of any one or combination of these means may be appropriate depending on the particular circumstances (for example, the risks of material misstatement related to the assertion being tested and the practicality and efficiency of the different means). [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Selecting All Items

.A70 The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance (or a stratum within that population). A 100 percent examination is unlikely in the case of tests of controls; however, it may be more common for tests of details. A 100 percent examination may be appropriate when, for example

- the population constitutes a small number of large value items,
- a significant risk exists and other means do not provide sufficient appropriate audit evidence, or
- the repetitive nature of a calculation or other process performed automatically by an information system makes a 100 percent examination cost effective.

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[14]Paragraph .07 of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Selecting Specific Items

.A71 The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include the auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific items is subject to nonsampling risk. Specific items selected may include

- high value or key items. The auditor may decide to select specific items within a population because they are of high value or exhibit some other characteristic (for example, items that are suspicious, unusual, particularly risk prone, or have a history of error).
- all items over a certain amount. The auditor may decide to examine items whose recorded values exceed a certain amount in order to verify a large proportion of the total amount of a class of transactions or account balance.
- items to obtain information. The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A72 Although selective examination of specific items from a class of transactions or account balance often will be an efficient means of obtaining audit evidence, it does not constitute audit sampling. Consequently, the results of audit procedures applied to items selected in this way cannot be projected to the entire population; furthermore, selective examination of specific items does not, by itself, provide sufficient appropriate audit evidence concerning the remainder of the population. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Audit Sampling

.A73 Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from the population. Audit sampling is discussed in section 530. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A74 Valid conclusions ordinarily may be drawn using sampling approaches. However, if the sample size is too small, the sampling approach or the method of selection is not appropriate to achieve the specific audit objective or exceptions are not appropriately followed up, an unacceptable risk will exist that the auditor's conclusion based on a sample may be different from the conclusion reached if the entire population was subjected to the same audit procedure. Section 530 addresses planning, performing, and evaluating audit samples.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Adequacy of Presentation of the Financial Statements (Ref: par. .26)

.A75 Evaluating the appropriate presentation, structure, and content of the financial statements includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the level of detail provided, the aggregation and disaggregation of amounts, and the bases of amounts set forth. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: par. .27–.29)

.A76 An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based. For example

- the extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's professional judgment about the risk assessments and indicate a significant deficiency or material weakness in internal control.
- the auditor may become aware of discrepancies in accounting records or conflicting or missing evidence.
- analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks of material misstatement and the effect on the significant classes of transactions, account balances, or disclosures and their relevant assertions. SAS No. 145 contains further guidance on revising the auditor's risk assessment.[15] [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A77 By performing audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements. However, accounting records alone do not provide sufficient appropriate audit evidence on which to base an audit opinion on the financial statements. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

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[15] Paragraph .32 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A78 The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A79 The auditor's conclusion of whether sufficient appropriate audit evidence has been obtained is both at the relevant assertion level as well as the financial statement level. Section 500 enables the auditor to evaluate the results of audit procedures to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained as required by paragraph .28. The auditor's professional judgment about what constitutes sufficient appropriate audit evidence is influenced by the following additional factors:

- Significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements (see section 450, *Evaluation of Misstatements Identified During the Audit*)
- Effectiveness of management's responses and controls to address the risks
- Experience gained during previous audits with respect to similar potential misstatements
- Whether the audit procedures that were performed identified specific instances of fraud or error
- Understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Documentation (Ref: par. .30)

.A80 The form and extent of audit documentation is a matter of professional judgment and is influenced by the nature, size, and complexity of the entity; system of internal control of the entity; availability of information from the entity; and the audit methodology and technology used in the audit. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

AU-C Section 402

Audit Considerations Relating to an Entity Using a Service Organization

Source: SAS No. 122; SAS No. 128; SAS No. 130; SAS No. 145.

See section 9402 for interpretations of this section.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the user auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of a user entity that uses one or more service organizations. Specifically, it expands on how the user auditor applies section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, in obtaining an understanding of the user entity, including the entity's system of internal control relevant to the preparation of the financial statements, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.02 Many entities outsource aspects of their business activities to organizations that provide services ranging from performing a specific task under the direction of the entity to replacing entire business units or functions of the entity. Many of the services provided by such organizations are integral to the entity's business operations; however, not all of those services are relevant to the audit.

.03 Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services and the controls over them affect the user entity's information system relevant to the preparation of the financial statements. Most controls at the service organization are likely to be part of the user entity's information system relevant to the preparation of the financial statements or other related controls, such as controls over the safeguarding of assets. A service organization's services are part of a user entity's information system if these services affect any of the following:

a. How information relating to significant classes of transactions, account balances, and disclosures flows through the user entity's information system, whether manually or using IT, and whether obtained from within or outside the general ledger and subsidiary ledgers. This includes when the service organization affects the following:
   i. How transactions of the user entity are initiated and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements
   ii. How information about events or conditions, other than transactions, is captured, processed, and disclosed by the user entity in the financial statements
b. The accounting records, specific accounts in the user entity's financial statements, and other supporting records relating to the flows of information in paragraph .03*a*.
c. The financial reporting process used to prepare the user entity's financial statements from the records described in paragraph .03b, including as it relates to disclosures and accounting estimates relating to significant classes of transactions, account balances, and disclosures
d. The entity's IT environment relevant to preceding subparagraphs (a)–(c)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.04 The nature and extent of work to be performed by the user auditor regarding the services provided by a service organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

.05 This section does not apply to services that are limited to processing an entity's transactions that are specifically authorized by the entity, such as the processing of checking account transactions by a bank or the processing of securities transactions by a broker (that is, when the user entity retains responsibility for authorizing the transactions and maintaining the related accountability). In addition, this section does not apply to the audit of transactions arising from an entity that holds a proprietary financial interest in another entity, such as a partnership, corporation, or joint venture, when the partnership, corporation, or joint venture performs no processing on behalf of the entity.

Effective Date

.06 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.07 The objectives of the user auditor, when the user entity uses the services of a service organization, are to

a. obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's system of internal control sufficient to provide an appropriate basis for the identification and assessment of the risks of material misstatement.

b. design and perform audit procedures responsive to those risks.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Definitions

.08 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Complementary user entity controls. Controls that management of the service organization assumes, in the design of its service, will be implemented by user entities and are necessary to achieve the control objectives stated in management's description of the service organization's system.

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls (referred to in this section as a *type 1 report*)**.** A report that comprises the following:

a. Management's description of the service organization's system

b. A written assertion by management of the service organization about whether, in all material respects, and based on suitable criteria

   i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date

c. A service auditor's report that expresses an opinion on the matters in *b*(i–ii)

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls (referred to in this section as a *type 2 report*)**.** A report that comprises the following:

a. Management's description of the service organization's system

b. A written assertion by management of the service organization about whether in all material respects and, based on suitable criteria

   i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives

   iii. the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives

c. A service auditor's report that

   i. expresses an opinion on the matters in *b*(i–iii)

   ii. includes a description of the service auditor's tests of controls and the results thereof

Service auditor. A practitioner who reports on controls at a service organization.

Service organization. An organization or segment of an organization that provides services to user entities that are relevant to those user entities' internal control over financial reporting.

Service organization's system. The policies and procedures designed, implemented, and documented by management of the service organization to provide user entities with the services covered by the service auditor's report. Management's description of the service organization's system identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls.

Subservice organization. A service organization used by another service organization to perform some of the services provided to user entities that are relevant to those user entities' internal control over financial reporting. (Ref: par. .A20)

User auditor. An auditor who audits and reports on the financial statements of a user entity.

User entity. An entity that uses a service organization and whose financial statements are being audited.

[Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SSAE No. 18.]

Requirements

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

.09 When obtaining an understanding of the user entity in accordance with section 315, the user auditor should obtain an understanding of how the user entity uses the services of a service organization in the user entity's operations, including the following:[1] (Ref: par. .A1–.A2)

a. The nature of the services provided by the service organization and the significance of those services to the user entity, including their effect on the user entity's internal control (Ref: par. .A3–.A5)

b. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization (Ref: par. .A6)

c. The degree of interaction between the activities of the service organization and those of the user entity (Ref: par. .A7)

d. The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization (Ref: par. .A8–.A11)

.10 When obtaining an understanding of the entity's system of internal control in accordance with section 315,[2] the user auditor should identify controls in the control activities component at the user entity from those that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization, and evaluate their design and determine whether they have been implemented.[3] (Ref: par. .A12–.A14) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.11 The user auditor should determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's system of internal control has been obtained to provide an appropriate basis for the identification and assessment of the risks of material misstatement. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[1]Paragraph .12 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[2]Paragraph .27 of section 315. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[3]Paragraph .29 of section 315. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.12 If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor should obtain that understanding from one or more of the following procedures:

a. Obtaining and reading a type 1 or type 2 report, if available

b. Contacting the service organization, through the user entity, to obtain specific information

c. Visiting the service organization and performing procedures that will provide the necessary information about the controls at the service organization that address risks of material misstatement at the assertion level in accordance with section 315[4]

d. Using another auditor to perform procedures that will provide the necessary information about the controls at the service organization that address risks of material misstatement at the assertion level in accordance with section 315[5] (Ref: par. .A15–.A20)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization

.13 In determining the sufficiency and appropriateness of the audit evidence provided by a type 1 or type 2 report, the user auditor should be satisfied regarding the following:

a. The service auditor's professional competence and independence from the service organization

b. The adequacy of the standards under which the type 1 or type 2 report was issued (Ref: par. .A21–.A23)

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.14 If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of identified controls at the service organization, the user auditor should

a. evaluate whether the type 1 report is as of a date, or in the case of a type 2 report, is for a period that is appropriate for the user auditor's purposes;

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[4]Paragraphs .27 and .29*b* of section 315. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[5]Paragraphs .35–.37 of section 315. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

b. evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the identified controls at the service organization; and

c. determine whether complementary user entity controls identified by the service organization address the risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtain an understanding of whether the user entity has designed and implemented such controls. (Ref: par. .A24–.A25)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Responding to the Assessed Risks of Material Misstatement

.15 In responding to assessed risks in accordance with section 330, the user auditor should

a. determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity and, if not,

b. perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the user auditor's behalf. (Ref: par. .A26–.A30)

Tests of Controls

.16 When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively, the user auditor should obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:

a. Obtaining and reading a type 2 report, if available

b. Performing appropriate tests of controls at the service organization

c. Using another auditor to perform tests of controls at the service organization on behalf of the user auditor (Ref: par. .A31–.A32)

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively

.17 If, in accordance with paragraph .16*a*, the user auditor plans to use a type 2 report as audit evidence that identified controls at the service organization are operating effectively, the user auditor should determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by

a. evaluating whether the type 2 report is for a period that is appropriate for the user auditor's purposes;

b. determining whether complementary user entity controls identified by the service organization address the risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;

c. evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and

d. evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment. (Ref: par. .A33–.A41)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Type 1 and Type 2 Reports That Exclude the Services of a Subservice Organization

.18 If the user auditor plans to use a type 1 or a type 2 report that excludes the services provided by a subservice organization and those services are relevant to the audit of the user entity's financial statements, the user auditor should apply the requirements of this section with respect to the services provided by the subservice organization. (Ref: par. .A42)

Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements Related to Activities at the Service Organization

.19 The user auditor should inquire of management of the user entity about whether the service organization has reported to the user entity, or whether the user entity is otherwise aware of, any fraud, noncompliance with laws and regulations, or uncorrected misstatements affecting the financial statements of the user entity. The user auditor should evaluate how such matters, if any, affect the nature, timing, and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report. (Ref: par. .A43)

Reporting by the User Auditor

.20 The user auditor should modify the opinion in the user auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements. (Ref: par. .A44)

.21 The user auditor should not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion. (Ref: par. .A45)

.22 If reference to the work of a service auditor is relevant to an understanding of a modification of the user auditor's opinion, the user auditor's report should indicate that such reference does not diminish the user auditor's responsibility for that opinion. (Ref: par. .A45)

Application and Other Explanatory Material

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

Sources of Information (Ref: par. .09)

.A1 Information about the nature of the services provided by a service organization may be available from a wide variety of sources, such as the following:

- User manuals
- System overviews
- Technical manuals
- The contract or service level agreement between the user entity and the service organization
- Reports by service organizations, the internal audit function, or regulatory authorities on controls at the service organization
- Reports by the service auditor, if available

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A2 Knowledge obtained through the user auditor's experience with the service organization—for example, through experience with other audit engagements—may also be helpful in obtaining an understanding of the nature of the services provided by the service organization. This may be particularly helpful if the services and controls at the service organization over those services are highly standardized.

Nature of the Services Provided by the Service Organization (Ref: par. .09a)

.A3 A user entity may use a service organization, such as one that processes transactions and maintains the related accountability for the user entity or records transactions and processes related data. Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage servicers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions.

.A4 Examples of services provided by service organizations that may be relevant to the audit include the following:

- Maintenance of the user entity's accounting records
- Management of the user entity's assets
- Initiating, authorizing, recording, or processing transactions as an agent of the user entity

Considerations Specific to Smaller Entities

.A5 Smaller entities may use external bookkeeping services ranging from the processing of certain transactions (for example, payment of payroll taxes) and maintenance of their accounting records to the preparation of their financial statements. The use of such a service organization for the preparation of its financial statements does not relieve management of the smaller entity and, when appropriate, those charged with governance of their responsibilities for the financial statements.[6]

Nature and Materiality of Transactions Processed by the Service Organization (Ref: par. .09b)

.A6 A service organization may establish policies and procedures (controls) that affect the user entity's internal control. These controls are at least in part physically and operationally separate from the user entity. The significance of the controls at the service organization to the user entity's internal control depends on the nature of the services provided by the service organization, including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the service organization may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of controls over the processing of those transactions is necessary in the circumstances.

The Degree of Interaction Between the Activities of the Service Organization and the User Entity (Ref: par. .09c)

.A7 The significance of the controls at the service organization to the user entity's internal control also depends on the degree of interaction between the service organization's activities and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organization. For example, a high degree of interaction exists between the activities of the user entity and those at the service organization when the user entity authorizes transactions and the service organization processes and accounts for those transactions. In these circumstances, it may be practicable for the user entity to implement effective controls over those transactions. On the other hand, when the service organization initiates or initially records, processes, and accounts for the user entity's transactions, a lower degree of interaction exists between the two organizations. In these circumstances, the

[6]Paragraph .05 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

user entity may be unable to, or may elect not to, implement effective controls over these transactions at the user entity and may rely on controls at the service organization.

Nature of the Relationship Between the User Entity and the Service Organization (Ref: par. .09d)

.A8 The contract or service level agreement between the user entity and the service organization may provide for matters such as the following:

- The information to be provided to the user entity and the responsibilities for initiating transactions relating to the activities undertaken by the service organization
- Complying with the requirements of regulatory bodies concerning the form of records to be maintained or access to them
- The indemnification, if any, to be provided to the user entity in the event of a performance failure
- Whether the service organization will provide a report on its controls and, if so, whether such a report will be a type 1 or type 2 report
- Whether the user auditor has rights of access to the accounting records of the user entity maintained by the service organization and other information necessary for the conduct of the audit
- Whether the agreement allows for direct communication between the user auditor and the service auditor

.A9 A direct relationship exists between the service organization and the user entity when the user entity enters into an agreement with the service organization, and between the service organization and the service auditor when the service organization engages the service auditor. These relationships do not create a direct relationship between the user auditor and the service auditor.

.A10 Communications between the user auditor and the service auditor usually are conducted through the user entity and the service organization. A user auditor may request through the user entity that a service auditor perform procedures for the benefit of the user auditor. For example, a service auditor may be engaged by the service organization to perform an agreed-upon procedures engagement related to testing controls at a service organization or performing procedures related to a user entity's transactions or balances maintained by the service organization. AT-C section 215, *Agreed-Upon Procedures Engagements*, establishes standards and provides guidance for agreed-upon procedures engagements. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Considerations Specific to Governmental Entities

.A11 For governmental entities, the auditor may be required to perform audit procedures with respect to the entity's compliance with laws and regulations. Such required procedures may include obtaining an understanding of internal control over compliance, performing tests of controls over compliance, and performing tests of compliance. Consequently, auditors of governmental entities that use a service organization may determine that it is appropriate to request, through the governmental entity, that the service auditor perform specified compliance-related audit procedures with respect to services provided by the service organization.[7]

Understanding the Controls Relating to Services Provided by the Service Organization (Ref: par. .10)

.A12 The user entity may establish controls over the service organization's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions, regardless of the controls in place at the service organization. If a user entity, for example, uses a service organization to process its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent, or detect and correct, material misstatements. These controls may include the following:

- Comparing the data submitted to the service organization with reports of information received from the service organization after the data has been processed
- Recomputing a sample of the payroll amounts for clerical accuracy and reviewing the total amount of the payroll for reasonableness

.A13 In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.

.A14 As noted in section 315, for some risks the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.[8] Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances that may involve highly automated processing with little or no manual intervention. Risks related to such automated processing may be particularly present when the user entity uses a service organization. In such cases, the user auditor is required to identify controls over such risks and to evaluate the design of such controls and determine whether they have been implemented in accordance with paragraph .10 of this section. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity (Ref: par. .12)

.A15 The user auditor's decision regarding which procedure, individually or in combination, in paragraph .12 to undertake in order to obtain the information necessary to provide a basis for the identification and assessment of the risks of material misstatement regarding

[7]Section 935, *Compliance Audits*, addresses audits of an entity's compliance.

[8]Paragraph .31 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

the user entity's use of the service organization, may be influenced by such matters as the following:

- The size of both the user entity and the service organization
- The complexity of the transactions at the user entity and the complexity of the services provided by the service organization
- The location of the service organization (for example, the user auditor may decide to use another auditor to perform procedures at the service organization on the user auditor's behalf if the service organization is in a remote location)
- Whether the procedure(s) is expected to effectively provide the user auditor with sufficient appropriate audit evidence
- The nature of the relationship between the user entity and the service organization

.A16 A service organization may engage a service auditor to report on the description and design of its controls (type 1 report) or on the description and design of its controls and their operating effectiveness (type 2 report). Type 1 or type 2 reports may be issued under AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, or under standards promulgated by an authorized or recognized standards-setting organization (for example, the International Auditing and Assurance Standards Board). [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A17 The availability of a type 1 or type 2 report generally will depend on whether the contract between the service organization and the user entity includes the provision of such a report by the service organization. A service organization may also elect, for practical reasons, to make a type 1 or type 2 report available to the user entities. However, in some cases, a type 1 or type 2 report may not be available to user entities.

.A18 In some circumstances, a user entity may outsource one or more significant business units or functions, such as its entire tax planning and compliance functions, finance and accounting functions, or the controllership function to one or more service organizations. As a report on controls at the service organization may not be available in these circumstances, visiting the service organization may be the most effective procedure for the user auditor to gain an understanding of controls at the service organization because there is likely to be direct interaction of management of the user entity with management of the service organization.

.A19 Another auditor may be used to perform procedures that will provide the necessary information about the controls at the service organization related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, useful as it relates to understanding another auditor (including that auditor's independence and professional competence); involvement in the work of another auditor in planning the nature, extent, and timing of such work; and in evaluating the sufficiency and appropriateness of the audit evidence obtained.[9] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A20 A user entity may use a service organization that in turn uses a subservice organization to provide some of the services provided to a user entity that are relevant to those user entities' internal control over financial reporting. The subservice organization may be a separate entity from the service organization or may be related to the service organization. A user auditor may need to consider controls at the subservice organization. In situations in which one or more subservice organizations are used, the interaction between the activities of the user entity and those of the service organization is expanded to include the interaction between the user entity, the service organization, and the subservice organizations. The degree of this interaction as well as the nature and materiality of the transactions processed by the service organization and the subservice organizations are the most important factors for the user auditor to consider in determining the significance of the service organization's and subservice organization's controls to the user entity's controls. (Ref: par. .08)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization (Ref: par. .13–.14)

.A21 The user auditor may make inquiries about the service auditor to the service auditor's professional organization or other practitioners and inquire whether the service auditor is subject to regulatory oversight. The service auditor may be practicing in a jurisdiction in which different standards are followed with respect to reports on controls at a service organization. In such a situation, the user auditor may obtain information about the standards used by the service auditor from the standards-setting organization in that jurisdiction.

.A22 Unless evidence to the contrary comes to the user auditor's attention, a service auditor's report implies that the service auditor is independent of the service organization. However, a service auditor need not be independent of the user entities.

.A23 Standards promulgated by a body designated by Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct are presumed to be adequate. Although the International Auditing and Assurance Standards Board (IAASB) is not such a body, AT-C section 320 may be helpful when the service auditor's report is issued in accordance with International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, promulgated by the IAASB.[10] [Paragraph added, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

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[9]Paragraphs .02 and .22 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[10][Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A24 A type 1 or type 2 report, along with information about the user entity, may assist the user auditor in obtaining an understanding of the following:

a. The controls at the service organization that may affect the processing of the user entity's transactions, including the use of subservice organizations

b. The flow of significant transactions through the service organization's system to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur

c. The control objectives stated in the description of the service organization's system that are relevant to the user entity's financial statement assertions

d. Whether controls at the service organization are suitably designed and implemented to prevent, or detect and correct, processing errors that could result in material misstatements in the user entity's financial statements

A type 1 or type 2 report may assist the user auditor in obtaining a sufficient understanding to identify and assess the risks of material misstatement of the user entity's financial statements. A type 1 report, however, does not provide any evidence of the operating effectiveness of the controls. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A25 A type 1 report that is as of a date, or a type 2 report that is for a period outside of the reporting period of a user entity, may assist the user auditor in obtaining a preliminary understanding of the controls implemented at the service organization if the report is supplemented by additional current information from other sources. If the description of the service organization's system is as of a date or for a period that precedes the beginning of the period under audit, the user auditor may perform procedures to update the information in a type 1 or type 2 report, such as the following:

- Discussing changes at the service organization with user entity personnel who would be in a position to know of such changes
- Reviewing current documentation and correspondence issued by the service organization
- Discussing the changes with service organization personnel

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Responding to the Assessed Risks of Material Misstatement (Ref: par. .15)

.A26 Whether the use of a service organization increases a user entity's risk of material misstatement depends on the nature of the services provided and the controls over these services; in some cases, the use of a service organization may decrease a user entity's risk of material misstatement, particularly if the user entity itself does not possess the expertise necessary to undertake particular activities, such as initiating, processing, and recording transactions, or does not have adequate resources (for example, an IT system). [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A27 When the service organization maintains material elements of the accounting records of the user entity, direct access to those records may be necessary for the user auditor to obtain sufficient appropriate audit evidence relating to the operations of controls over those records, to substantiate transactions and balances recorded in them, or both. Such access may involve physical inspection of records at the service organization's premises or electronic interrogation of records, or both. When direct access is achieved electronically, the user auditor may also obtain evidence concerning the adequacy of the service organization's controls over the completeness and integrity of the user entity's data for which the service organization is responsible. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A28 In determining the nature and extent of audit evidence to be obtained for financial statement balances representing assets held or transactions processed by a service organization for a user entity, the following procedures may be considered by the user auditor:

a. *Inspecting records and documents held by the user entity.* The reliability of this source of evidence is determined by the nature and extent of the accounting records and supporting documentation retained by the user entity. In some cases, the user entity may not maintain independent detailed records or documentation of specific transactions undertaken on its behalf.

b. *Inspecting records and documents held by the service organization.* The user auditor's access to the records of the service organization may be established as part of the contractual arrangements between the user entity and the service organization. The user auditor may also use another auditor, on its behalf, to gain access to the user entity's records maintained by the service organization, or ask the service organization through the user entity for access to the user entity's records maintained by the service organization.

c. *Obtaining confirmations of balances and transactions from the service organization.* When the user entity maintains independent records of balances and transactions, confirmation from the service organization corroborating those records usually constitutes reliable audit evidence concerning the existence of the transactions and assets concerned. For example, when multiple service organizations are used, such as an investment manager and a custodian, and these service organizations maintain independent records, the user auditor may confirm balances with these organizations in order to compare this information with the independent records of the user entity. If the user entity does not maintain independent records, information obtained in confirmations from the service organization is merely a statement of what is reflected in the records maintained by the service organization. Therefore, such confirmations do not, taken alone, constitute reliable audit evidence. In these circumstances, the user auditor may consider whether an alternative source of independent evidence can be identified.

d. *Performing analytical procedures on the records maintained by the user entity or on the reports received from the service organization.* The effectiveness of analytical procedures is likely to vary by assertion and will be affected by the extent and detail of information available.

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A29 As noted in paragraph .A10, a service auditor may perform procedures under AT-C section 215 that are substantive in nature for the benefit of user auditors. Such an engagement may involve the performance by the service auditor of procedures agreed upon by the user entity and its user auditor and by the service organization and its service auditor. The findings resulting from the procedures performed by the service auditor are reviewed by the user auditor to determine whether they constitute sufficient appropriate audit evidence. In addition, requirements may be imposed by governmental authorities or through contractual arrangements whereby a service auditor performs designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organization may be used by the user auditor as part of the evidence necessary to support the user auditor's audit opinion. In these circumstances, it may be useful for the user auditor and the service auditor to establish an understanding prior to the performance of the procedures concerning the audit documentation or means of accessing the audit documentation that will be provided to the user auditor. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A30 In certain circumstances, in particular when a user entity outsources some or all of its finance function to a service organization, the user auditor may face a situation in which a significant portion of the audit evidence resides at the service organization. Substantive procedures may need to be performed at the service organization by the user auditor or the service auditor on behalf of the user auditor. A service auditor may provide a type 2 report and, in addition, may perform substantive procedures on behalf of the user auditor. As noted in paragraph .A44, the involvement of a service auditor does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Accordingly, relevant information for the user auditor to consider when determining whether sufficient appropriate audit evidence has been obtained and whether the user auditor needs to perform further substantive procedures includes the user auditor's involvement with, or evidence of, the direction, supervision, and performance of the substantive procedures performed by the service auditor. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Tests of Controls (Ref: par. .16)

.A31 The user auditor is required by section 330 to design and perform tests of controls to obtain sufficient appropriate audit evidence concerning the operating effectiveness of controls in certain circumstances.[11] In the context of a service organization, this requirement applies when

a. the user auditor's assessment of risks of material misstatement includes an expectation that the controls at the service organization are operating effectively (that is, the user auditor intends to rely on the operating effectiveness of controls at the service organization in determining the nature, timing and extent of substantive procedures); or

b. substantive procedures alone, or in combination with tests of the operating effectiveness of controls at the user entity, cannot provide sufficient appropriate audit evidence at the assertion level.

[Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A32 If a type 2 report is not available, a user auditor may contact the service organization through the user entity to request that a service auditor be engaged to perform a type 2 engagement that includes tests of the operating effectiveness of the controls or the user auditor may use another auditor to perform agreed-upon procedures at the service organization that test the operating effectiveness of those controls. A user auditor may also visit the service organization and perform tests of controls if the service organization agrees to it. The user auditor's risk assessments are based on the combined evidence provided by the service auditor's report and the user auditor's own procedures. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively (Ref: par. .17)

.A33 A type 2 report may be intended to satisfy the needs of several different user auditors; therefore, specific tests of controls and results described in a type 2 report may not be relevant to assertions that are significant in the user entity's financial statements. The relevant tests of controls and results of the tests are evaluated to determine whether the type 2 report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. In doing so, the user auditor may consider the following factors:

a. The time period covered by the tests of controls and the time elapsed since the performance of the tests of controls

b. The scope of the service auditor's work and the services and processes covered, the controls tested and the tests that were performed, and the way in which tested controls relate to the user entity's controls

c. The results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls

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[11] Paragraph .08 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 130, December 2016. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A34 For certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less audit evidence the test may provide. In comparing the period covered by the type 2 report to the user entity's financial reporting period, the user auditor may conclude that the type 2 report offers less audit evidence if little overlap exists between the period covered by the type 2 report and the period for which the user auditor intends to rely on the report. When this is the case, an additional type 2 report covering a preceding or subsequent period may provide additional audit evidence. In other cases, the user auditor may determine it is necessary to perform, or use another auditor to perform, tests of controls at the service organization in order to obtain sufficient appropriate audit evidence about the operating effectiveness of those controls. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A35 It may also be necessary for the user auditor to obtain additional evidence about significant changes in the controls at the service organization during a period outside the period covered by the type 2 report, or to determine what additional audit procedures need to be performed (for example, when little or no overlap exists between the period covered by the type 2 report and the period covered by the user entity's financial statements). Relevant factors in determining what additional audit evidence to obtain about controls at the service organization that were operating outside the period covered by the service auditor's report may include the following:

- The significance of the assessed risks of material misstatement at the assertion level
- The specific controls that were tested during the interim period and significant changes to them since they were tested, including changes in the information systems, processes, and personnel
- The degree to which audit evidence about the operating effectiveness of those controls was obtained
- The length of the remaining period
- The extent to which the user auditor intends to reduce further substantive procedures based on the reliance on controls
- The effectiveness of the control environment and the user entity's process to monitor the system of internal controls

[Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A36 Additional audit evidence may be obtained, for example, by performing tests of controls that operated during the remaining period or testing the user entity's process to monitor the system of internal control. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A37 If the service auditor's testing period is completely outside the user entity's financial reporting period, the user auditor will be unable to rely on such tests to conclude that the user entity's controls are operating effectively because the tests do not provide current audit period evidence of the effectiveness of the controls, unless other procedures are performed. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A38 In certain circumstances, a service provided by the service organization may be designed with the assumption that certain controls will be implemented by the user entity. For example, the service may be designed with the assumption that the user entity will have controls in place for authorizing transactions before they are sent to the service organization for processing. In such a situation, the description of the service organization's system may include a description of those complementary user entity controls. The user auditor considers whether those complementary user entity controls are relevant to the service provided to the user entity. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A39 If the user auditor believes that the service auditor's report may not provide sufficient appropriate audit evidence (for example, if a service auditor's report does not contain a description of the service auditor's tests of controls and results thereof), the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by contacting the service organization through the user entity to request a discussion with the service auditor about the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organization through the user entity to request that the service auditor perform procedures at the service organization, or the user auditor may perform such procedures. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A40 The service auditor's type 2 report identifies results of tests, including deviations, and other information that could affect the user auditor's conclusions. Deviations noted by the service auditor or a modified opinion in the service auditor's report do not automatically mean that the service auditor's report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the deviations and the matter giving rise to a modified opinion in the service auditor's type 2 report are considered in the user auditor's assessment of the tests of controls performed by the service auditor. In considering the deviations and matters giving rise to a modified opinion, the user auditor may discuss such matters with the service auditor. Such communication is dependent upon the user entity contacting the service organization, and obtaining the service organization's approval for the communication to take place. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A41 *Communication of significant deficiencies and material weaknesses in internal control identified during the audit*. The user auditor is required by section 265, *Communicating Internal Control Related Matters Identified in an Audit*, to communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the audit.[12] Matters related to the use of a service organization that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include the following:

- Any controls within the entity's process to monitor the system of internal control that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 report
- Instances when complementary user entity controls identified in the type 1 or type 2 report are not implemented at the user entity
- Controls that may be needed at the service organization that do not appear to have been implemented or that were implemented, but are not operating effectively

The auditor also may communicate other control related matters, including deficiencies that are not significant deficiencies or material weaknesses. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Type 1 and Type 2 Reports That Exclude the Services of a Subservice Organization (Ref: par. .18)

.A42 If a service organization uses a subservice organization, the service auditor's report may either include or exclude the subservice organization's relevant control objectives and related controls in the service organization's description of its system and in the scope of the service auditor's engagement. These two methods of reporting are known as the *inclusive method* and the *carve-out method*, respectively. If the type 1 or type 2 report excludes the controls at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of this section with respect to the subservice organization. The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit. The application of the requirement in paragraph .09 assists the user auditor in determining the effect of the subservice organization and the nature and extent of work to be performed. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements Related to Activities at the Service Organization (Ref: par. .19)

.A43 A service organization may be required under the terms of the contract with user entities to disclose to affected user entities any fraud, noncompliance with laws and regulations, or uncorrected misstatements attributable to the service organization's management or employees. As required by paragraph .19, the user auditor makes inquiries of the user entity management regarding whether the service organization has reported any such matters and evaluates whether any matters reported by the service organization

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[12]Paragraphs .11–.12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 130, December 2016. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

affect the nature, timing, and extent of the user auditor's further audit procedures. In certain circumstances, the user auditor may require additional information to perform this evaluation and may request that the user entity contact the service organization to obtain the necessary information. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Reporting by the User Auditor (Ref: par. .20)

.A44 When a user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements, a limitation on the scope of the audit exists. This may be the case when

- the user auditor is unable to obtain a sufficient understanding of the services provided by the service organization and does not have a basis for the identification and assessment of the risks of material misstatement;
- a user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively and the user auditor is unable to obtain sufficient appropriate audit evidence about the operating effectiveness of these controls; or
- sufficient appropriate audit evidence is only available from records held at the service organization, and the user auditor is unable to obtain direct access to these records.

Whether the user auditor expresses a qualified opinion or disclaims an opinion depends on the user auditor's conclusion regarding whether the possible effects on the financial statements are material, pervasive, or both.[13] [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Reference to the Work of the Service Auditor (Ref: par. .21–.22)

.A45 The fact that a user entity uses a service organization does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Therefore, the user auditor does not make reference to the service auditor's report as a basis, in part, for the user auditor's opinion on the user entity's financial statements. However, when the user auditor expresses a modified opinion because of a modified opinion in a service auditor's report, the user auditor is not precluded from referring to the service auditor's report if such reference assists in explaining the reason for the user auditor's modified opinion. In such circumstances, the user auditor need not identify the service auditor by name and may need the consent of the service auditor before making such a reference. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

[13]Paragraphs .07–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 130, December 2016. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

AU-C Section 9402

Audit Considerations Relating to an Entity Using a Service Organization: Auditing Interpretations of Section 402

1. Considerations Related to the Use of a SOC 2®[1] Report in an Audit of a User Entity's Financial Statements

.01 *Question* — Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, defines a *user entity* as an entity that uses a service organization and whose financial statements are being audited. It also defines a *service organization* as an organization or segment of an organization that provides services to user entities that are relevant to those user entities' internal control over financial reporting (ICFR). When a service organization does not provide a SOC 1®[2] report or a similar report issued under, for example, International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*, but does provide a SOC 2® report relevant to the services used by the user entity, may the auditor of a user entity's financial statements (a user auditor) use the SOC 2 report to meet the objectives of section 402?

.02 *Interpretation* — Section 402 contains requirements and guidance for a user auditor on (*a*) obtaining an understanding of the nature and significance of the services provided by a service organization and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement, and (*b*) designing and performing audit procedures responsive to those risks.[3]

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[1]The AICPA introduced the term *system and organization controls* (SOC) to refer to the suite of services practitioners may provide relating to system-level controls of a service organization and system or entity-level controls of other organizations. A SOC 2® engagement is an examination of controls over the security, availability, or processing integrity of a system or the confidentiality or privacy of the information processed by the system. It is performed under AT-C section 205, *Assertion-Based Examination Engagements.* AICPA Guide *Reporting on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy (SOC 2®)* is an interpretive publication that addresses SOC 2 engagements and provides recommendations on the application of AT-C section 205 to such engagements.

[2]A SOC 1® engagement is an examination engagement performed under AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*.

[3]This paragraph is replaced with the following to reflect the issuance of Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which has been codified in section 315:

> Section 402 contains requirements and guidance for a user auditor on (*a*) obtaining an understanding of the nature and significance of the services provided by a service organization and their effect on the user entity's system of internal control, sufficient to provide an

.03 A service auditor performs a SOC 1 engagement under AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, which is an attestation standard specifically designed to enable a service auditor to report on management of a service organization's description of its system (description) and the service organization's controls included in the description that are relevant to a user entity's ICFR. A SOC 1 report addresses the risks related to a financial statement audit and is intended to complement section 402. As such, a SOC 1 report or an equivalent report issued under, for example, ISAE 3402, is the preferred report for use in an audit of a user entity's financial statements. When a SOC 1 report is unavailable, a user auditor may be able to obtain relevant information from other types of attestation reports. One such report is a report on an examination of controls at a service organization relevant to one or more of the trust services categories of criteria, which include security, availability, processing integrity, confidentiality, and privacy (SOC 2 report).

.04 Although a SOC 2 report may provide a user auditor with information about the nature of the services provided by the service organization and the suitability of the design and operating effectiveness of certain controls at the service organization, a SOC 2 report is not specifically designed to address controls at a service organization relevant to a user entity's ICFR and therefore is unlikely to achieve the intent of the requirements in section 402. Because a SOC 2 report is not designed to serve the same purpose as a SOC 1 report, an understanding of the differences between these two types of reports may assist a user auditor in evaluating the sufficiency and appropriateness of the evidence provided by a SOC 2 report in an audit of a user entity's financial statements. The following are some considerations when determining whether a SOC 2 report may be used in the audit of a user entity's financial statements and some of the limitations of using a SOC 2 report in these circumstances:

- *Purpose of the report.* A SOC 2 engagement, which is performed under AT-C section 205, *Assertion-Based Examination Engagements*, addresses controls at a service organization that are intended to provide reasonable assurance that the service organization's service commitments and system requirements are achieved, based on the applicable trust services criteria. Importantly, a SOC 2 engagement is not designed to address the services performed by a service organization that are likely to be relevant to a user entity's ICFR and therefore is unlikely to completely address the effect that the service organization has on a user entity's financial reporting.

- *Potential overlap with financial reporting.* A SOC 2 report may address certain areas that could be relevant to a user entity's ICFR, such as logical access and change management. However, in a SOC 2 engagement, the service auditor's tests of such

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appropriate basis for the identification and assessment of the risks of material misstatement, and (*b*) designing and performing audit procedures responsive to those risks.

SAS No. 145, issued in October 2021, is effective for audits of financial statements for periods ending on or after December 15, 2023. The distinct presentation of this content (as gray shaded) is intended to aid the reader in differentiating content that may not be effective for the reader's purposes. This paragraph applies when SAS No. 145 is early implemented or upon its effective date.

controls may be designed to address a different set of risks and are unlikely to provide sufficient appropriate audit evidence regarding controls at a service organization relevant to a user entity's ICFR. For example, although the change management criterion in a SOC 2 engagement[4] addresses attributes in the change management life cycle that may be relevant to a user entity's ICFR (for example, testing, approval, and implementation of changes into production), the service organization's service commitments and system requirements in a SOC 2 engagement typically address the effect that the change has on the security and availability of systems and therefore may not address the completeness, accuracy, and timeliness of the processing and reporting of transactions and balances relevant to a user entity's ICFR.

- *Scope of the report and understanding of the nature of the services provided by the service organization.* Because a SOC 2 report is not specifically designed to address services relevant to a user entity's ICFR, the description in a SOC 2 report may not include all the services, reports, statements, processes, and controls relevant to a user entity's ICFR. In contrast, the criteria for the description in AT-C section 320 require that such information be included in the description in a SOC 1 report.[5] Accordingly, the use of a SOC 2 report in an audit of a user entity's financial statements involves careful evaluation of the scope of the report and the content of the description in determining the relevance of the report to a user entity's ICFR.

- *Complementary user entity controls.* In a SOC 2 report, complementary user entity controls (CUECs) represent controls that management of the service organization assumed, in the design of the service organization's system, would be implemented by user entities and are necessary, in combination with controls at the service organization to provide reasonable assurance that the service organization's service commitments and system requirements would be achieved, based on the applicable trust services criteria. However, in a SOC 1 report, the CUECs represent controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by user entities and are necessary to achieve a set of control objectives stated in the description that are relevant to user entities' ICFR. As a result, it is unlikely that a SOC 2 report will include the same set of CUECs that would be included in a SOC 1 report addressing similar services. The user auditor's careful analysis of the SOC 2 report is needed to identify (*a*) the CUECs included in a SOC 2 report, if any, that would need to be implemented at a user entity to achieve control objectives relevant to the user entity's ICFR, and (*b*) other controls that would need to be implemented by a user entity to mitigate the risks to the user entity's ICFR resulting from the use of a service organization (these controls are not identified as CUECs in a SOC 2 report). For example, if a service organization is responsible for performing logical access administration for users at the user entity, a SOC 1 report may include a CUEC indicating that the user entity provides complete, accurate, and appropriately authorized instructions for access changes. However, in

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[4]See CC8.1 in TSP section 100, *2017 Trust Services Criteria for Security, Availability, Processing Integrity, Confidentiality, and Privacy.*

All TSP sections can be found in AICPA *Trust Services Criteria*.

[5]Paragraph .15 of AT-C section 320.

a SOC 2 report, this control may not be identified as a CUEC because the service organization is able to meet its service commitments to administer access based on the instructions provided by the user entity, regardless of the completeness and accuracy of those instructions.

To identify additional user responsibilities relevant to a user entity's ICFR that are not presented in a SOC 2 report as CUECs, a user auditor may review the following:

- — Contracts, service level agreements, or other documents between the user entity and the service organization to obtain an understanding of the services performed
- — The extent to which those services are, or are not, addressed by the SOC 2 report
- — The service organization's and user entity's responsibilities, even if not identified in the SOC 2 report as SOC 2–related CUECs

- *Access to the SOC 2 report not provided to downstream users.* For carved-out subservice organizations, paragraph .A70 of AT-C section 320 indicates that a user entity is also considered a user entity of the service organization's subservice organizations if controls at the subservice organizations are relevant to the user entity's ICFR. Paragraph .A70 refers to such user entities as *indirect* or *downstream* user entities. Because the definition of *user entity* in a SOC 2 engagement is substantially the same as it is in a SOC 1 engagement, downstream user entities of a SOC 2 report would be considered intended users of a SOC 2 report.

- *Services provided by subservice organizations likely to be relevant to a user entity's ICFR.* An additional user auditor consideration is that the scope of a SOC 2 report may not include all the services provided by subservice organizations that are likely to be relevant to a user entity's ICFR. For example, although a service provider that provides pricing data for investments may be a relevant subservice organization for a SOC 1 report, it may not be relevant to the SOC 2 report based on the applicable trust services criteria, which are intended to address the service organization's service commitments and system requirements.

- *Information prepared for user entities.* The information included in a SOC 2 report may address information prepared for user entities that is relevant to the service organization's service commitments — for example, system uptime reports to address availability commitments and user access listings related to security commitments — but may not address other types of information and reports that would be relevant to a user entity's ICFR. In evaluating the usefulness of a SOC 2 report in an audit of a user entity's financial statements, relevant considerations may include whether the scope of the SOC 2 report includes controls over the completeness and accuracy of the reports provided to user entities that are relevant to the user entities' ICFR. For example, a SOC 2 report that addresses an investment management system may include security reports such as user access lists or system availability reports for the application but may not include reports relevant to a user entity's financial transactions such as investment positions or transactions.

- *Intended users of the report.* The restricted-use paragraph in a type 2 SOC 2 report indicates that the intended users of a SOC 2 report include user entities of the system during some or all of the period covered by the report and practitioners providing services to such user entities. A user auditor would qualify as a practitioner providing services to a user entity and therefore would be considered an intended user of a SOC 2 report.

- *Service auditor's consideration of deficiencies.* In a SOC 2 engagement, the service auditor evaluates identified deficiencies in the design or operating effectiveness of controls based on their effect on the service organization's service commitments and system requirements, as opposed to their effect on the service organization's identified control objectives, as is the case in a SOC 1 engagement.

.05 The following table summarizes how a SOC 2 report may address the requirements in paragraph .09 of section 402:

Requirement in Requirement in Paragraph .09 of Section 402	How a SOC 2 Report May Address the Requirement in How a SOC 2 Report May Address the Requirement in Paragraph .09 of Section 402
.09 A user auditor should obtain an understanding of how the user entity uses the services of a service organization in the user entity's operations, including the following:	
a. The nature of the services provided by the service organization and the significance of those services to the user entity, including their effect on the user entity's internal control	A SOC 2 report may be useful in understanding the nature of some of the services provided by the service organization, including the service organization's service commitments and controls relative to categories of trust services criteria such as security and processing integrity. However, due to the intended scope of the report, it may not address all the services relevant to a user entity's internal control over financial reporting.
b. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization	A SOC 2 report is unlikely to address the nature and materiality of transactions processed by the service organization unless it includes the processing integrity category of the trust services criteria.
c. The degree of interaction between the activities of the service organization and those of the user entity	A SOC 2 report may address the interaction between the activities of the service organization and those of the user entity especially as it relates to the service commitments that the service organization has made to its user entities based on the scope of the report.
d. The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization	Like a SOC 1 report, a SOC 2 report is unlikely to address the relevant contractual terms; however, it will provide some information about the relationship between the user entity and the service organization. For example, the disclosure of the service organization's key service commitments relative to the trust services categories of criteria that are addressed by the SOC 2 report may assist the user auditor in understanding the nature of the relationship between the user entity and the service organization.

[Issue Date: December 2022.]

AU-C Section 450

Evaluation of Misstatements Identified During the Audit

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 137; SAS No. 138.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

NOTE

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the auditor's responsibility in forming an opinion on the financial statements based on the evaluation of the audit evidence obtained. The auditor's conclusion, required by section 700 or section 703, takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements, in accordance with this section. Section 320, *Materiality in Planning and Performing an Audit*, addresses the auditor's responsibility to appropriately apply the concept of materiality in planning and performing an audit of financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to evaluate the effect of

a. identified misstatements on the audit and

b. uncorrected misstatements, if any, on the financial statements.

Definitions

.04 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Misstatement. A difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error. (Ref: par. .A1)

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Uncorrected misstatements. Misstatements that the auditor has accumulated during the audit and that have not been corrected.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Requirements

Accumulation of Identified Misstatements

.05 The auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: par. .A2–.A3)

Consideration of Identified Misstatements as the Audit Progresses

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

a. the nature of 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 or (Ref: par. .A7)

b. the aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with section 320.[1] (Ref: par. .A8)

Communication and Correction of Misstatements

.07 The auditor should communicate on a timely basis with the appropriate level of management all misstatements accumulated during the audit. The auditor should request management to correct those misstatements. (Ref: par. .A9–.A11)

.08 If, at the auditor's request, management has examined a class of transactions, account balance, or disclosure and corrected misstatements that were detected, the auditor should perform additional audit procedures to determine whether misstatements remain. (Ref: par. .A12–.A14)

.09 If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor should obtain an understanding of management's reasons for not making the corrections and should take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.[2] (Ref: par. .A15–.A18)

Evaluating the Effect of Uncorrected Misstatements

.10 Prior to evaluating the effect of uncorrected misstatements, the auditor should reassess materiality[3] to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: par. .A19–.A21)

.11 The auditor should determine whether uncorrected misstatements are material, individually or in the aggregate. In making this determination, the auditor should consider

a. the size and nature of the misstatements, both in relation to particular classes of transactions, account balances, or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and (Ref: par. .A22–.A29 and .A31–.A32)

b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances, or disclosures and the financial statements as a whole. (Ref: par. .A30)

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[1]Paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

[2]Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraph .38 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[3]Paragraph .12 of section 320.

Documentation

.12 The auditor should include in the audit documentation[4] (Ref: par. .A33)

a. the amount below which misstatements would be regarded as clearly trivial; (See paragraph .05)

b. all misstatements accumulated during the audit and whether they have been corrected; and (See paragraphs .05–.07)

c. the auditor's conclusion about whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion. (See paragraph .11)

Application and Other Explanatory Material

Definitions

Misstatement (Ref: par. .04)

.A1 Misstatements may result from fraud or error, such as

a. an inaccuracy in gathering or processing data from which the financial statements are prepared;

b. an omission of an amount or disclosure, including inadequate or incomplete disclosures and omission of those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable;

c. a financial statement disclosure that is not presented in accordance with the applicable financial reporting framework;

d. an incorrect accounting estimate arising from overlooking or clear misinterpretation of facts;

e. judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate;

f. an inappropriate classification, aggregation, or disaggregation of information; and

g. the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework.

Other examples of misstatements arising from fraud are provided in section 240, *Consideration of Fraud in a Financial Statement Audit*.[5] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

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[4] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Accumulation of Identified Misstatements (Ref: par. .05)

"Clearly Trivial"

.A2 Paragraph .05 requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial. "Clearly trivial" is not another expression for "not material." Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature, than those that would be determined to be material and will be misstatements that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the misstatement is considered not to be clearly trivial. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Misstatements in Individual Statements

.A3 The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount would be accumulated as required by paragraph .05. In addition, misstatements relating to amounts may not be clearly trivial based on their nature or circumstances and, if not clearly trivial, would be accumulated as required by paragraph .05 of this section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Misstatements in Disclosures

.A4 Misstatements in disclosures may also be clearly trivial whether taken individually or in the aggregate and whether judged based on size, nature, or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph .A23 provides examples of when misstatements in qualitative disclosures may be material. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Accumulation of Misstatements

.A5 Misstatements by nature or circumstances, accumulated as described in paragraphs .A3–.A4, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph .11 to evaluate those misstatements individually and in the aggregate (that is, collectively with other misstatements) to determine whether they are material. [Paragraph added, effective for

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[5] Paragraphs .A1–.A8 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A6 To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, the auditor may find it useful to distinguish between factual misstatements, judgmental misstatements, and projected misstatements, described as follows:

- *Factual misstatements* are misstatements about which there is no doubt.
- *Judgmental misstatements* are differences arising from the judgments of management including those concerning recognition, measurement, presentation, and disclosure in the financial statements (including the selection or application of accounting policies) that the auditor considers unreasonable or inappropriate.
- *Projected misstatements* are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in section 530, *Audit Sampling*.[6]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Consideration of Identified Misstatements as the Audit Progresses (Ref: par. .06)

.A7 A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, when the auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate assumptions or valuation methods that have been widely applied by the entity. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A8 If the aggregate of misstatements accumulated during the audit approaches materiality,[7] 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. Undetected misstatements could exist because of the presence of sampling risk and nonsampling risk.[8] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Communication and Correction of Misstatements (Ref: par. .07–.09)

.A9 Timely communication of misstatements to the appropriate level of management is important because it enables management to evaluate whether the classes of transactions,

[6]Paragraphs .13–.14 of section 530, *Audit Sampling*.

[7]Paragraph .12 of section 320.

[8]Paragraph .05 of section 530.

account balances, and disclosures are misstated, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and take the necessary action. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 Law or regulation may restrict the auditor's communication of certain misstatements to management or others within the entity. For example, laws or regulations may specifically prohibit a communication or other action that might prejudice an investigation by an appropriate authority into an instance of noncompliance or suspected noncompliance with laws or regulations. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider seeking legal advice. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A11 The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A12 The auditor may request management to examine a class of transactions, account balance, or disclosure in order for management to understand the cause of a misstatement identified by the auditor; perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance, or disclosure; and make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A13 The auditor may request management to record an adjustment needed to correct all factual misstatements, including the effect of prior period misstatements (see paragraph .08), other than those that the auditor believes are clearly trivial. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A14 When the auditor has identified a judgmental misstatement involving differences in estimates, such as a difference in a fair value estimate, the auditor may request management to review the assumptions and methods used in developing management's estimate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A15 Sections 700 and 703 require the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in accordance with the requirements of the applicable financial reporting framework.[9] This evaluation includes consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments, which may be affected by the auditor's understanding

[9] Paragraph .12 of section 700 and paragraph .37 of section 703, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

of management's reasons for not making the corrections (see section 700).[10] [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A16 Section 580, *Written Representations*, addresses management representations, including representations with respect to uncorrected misstatements.[11] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A17 In accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*, identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control is an indicator of a material weakness.[12] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A18 Section 260, *The Auditor's Communication With Those Charged With Governance*, addresses matters to be communicated by the auditor to those charged with governance, including uncorrected misstatements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

.A19 The auditor's determination of materiality in accordance with section 320 often is based on estimates of the entity's financial results because the actual financial results may not yet be known.[13] Therefore, prior to the auditor's evaluation of the effect of uncorrected misstatements, it may be necessary to revise materiality determined in accordance with section 320 based on the actual financial results. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A20 Section 320 explains that, as the audit progresses, materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) is revised in the event of the auditor becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.[14] Thus, any significant revision is likely to have been made before the auditor evaluates the effect of uncorrected misstatements. However, if the auditor's reassessment of materiality determined in accordance with section 320 (see paragraph .10 of this section) gives rise to a lower amount (or amounts), then performance materiality and the appropriateness of the nature, timing, and extent of the further audit procedures are reconsidered in order to obtain sufficient appropriate audit evidence on which to base the audit opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

[10]Paragraph .14 of section 700 and paragraph .39 of section 703, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[11]Paragraph .14 of section 580, *Written Representations*.

[12]Paragraph .A11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

[13]Paragraph .10 of section 320.

[14]Paragraph .12 of section 320.

.A21 Materiality is determined based on the auditor's understanding of the user needs and expectations (see section 320).[15] Although user expectations may differ based on inherent uncertainty associated with the measurement of particular items in the financial statements, these expectations have already been considered in the auditor's determination of materiality. For example, the fact that the financial statements include very large provisions with a high degree of estimation uncertainty (for example, provisions for insurance claims in the case of an insurance company; oil rig decommissioning costs in the case of an oil company; or, more generally, legal claims against an entity) may influence the auditor's assessment of what users might consider material. However, after materiality is reassessed, this section requires the auditor to evaluate any misstatements in accordance with that level of materiality, regardless of the degree of inherent uncertainty associated with the measurement of particular items in the financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A22 Each individual misstatement of an amount is considered to evaluate its effect on the relevant classes of transactions, account balances, or disclosures, including whether the materiality level for that particular class of transactions, account balance, or disclosure, if any, has been exceeded. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A23 In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosures, as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples of misstatements that may be material include the following:

- Inaccurate or incomplete descriptions of information about the objectives, policies, and processes for managing capital
- The omission of information about the events or circumstances that have led to an impairment loss (for example, a significant long-term decline in the demand for a metal or commodity)
- An incorrect description of an accounting policy relating to a significant item in any of the statements that the financial statements comprise
- An inadequate description of the sensitivity of an exchange rate

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A24 In determining whether uncorrected misstatements by nature are material as required by paragraph .11, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually or in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider the following:

[15] Paragraph .10 of section 320.

- Whether identified errors are recurring or pervasive
- Whether a number of identified misstatements are relevant to the same matter and, considered collectively, may affect the users' understanding of that matter

This consideration of accumulated misstatements is also helpful when evaluating the financial statements as discussed in paragraph .A15 of section 700, *Forming an Opinion and Reporting on Financial Statements*,[16] or paragraph .A70 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*,[17] which states that evaluating whether the financial statements achieve fair presentation may include discussions with management about whether the presentation of amounts or disclosures obscures useful information or results in misleading information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A25 The auditor is required by section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, to evaluate the effect on the group audit opinion of any uncorrected misstatement identified by the group engagement team or communicated by the component auditors.[18] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A26 If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements. For example, if revenue has been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on earnings is completely offset by an equivalent overstatement of expenses. 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. The auditor may need to reassess the risks of material misstatement for a specific account balance or class of transactions upon identification of a number of immaterial misstatements within that account balance or class of transactions. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A27 Determining whether a classification misstatement is material involves the evaluation of qualitative considerations, such as the effect of the classification misstatement on debt or other contractual covenants, the effect on individual line items or subtotals, or the effect on key ratios. Circumstances may exist in which the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements. For example, a misclassification between balance sheet line items may

[16] Paragraph .16 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[17] Paragraph .41 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[18] Paragraph .44 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

not be considered material in the context of the financial statements as a whole when the amount of the misclassification is small in relation to the size of the related balance sheet line items and the misclassification does not affect the income statement or any key ratios. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A28 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 lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement

- affects compliance with regulatory requirements.
- affects compliance with debt covenants or other contractual requirements.
- 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.
- masks a change in earnings or other trends, especially in the context of general economic and industry conditions.
- affects ratios used to evaluate the entity's financial position, results of operations, or cash flows.
- 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).
- has the effect of increasing management compensation (for example, by ensuring that the requirements for the award of bonuses or other incentives are satisfied).
- is significant with regard to the auditor's understanding of known previous communications to users (for example, regarding forecast earnings).
- relates to items involving particular parties (for example, whether external parties to the transaction are related to members of the entity's management).
- is 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.
- affects other information that will be communicated in documents containing the audited financial statements (for example, information to be included in a "Management Discussion and Analysis" or an "Operating and Financial Review") when there is substantial likelihood that the other information would influence the judgment made by a reasonable user based on the financial statements. Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, addresses the auditor's responsibilities relating to other information, whether

financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report.

- is a misclassification between certain account balances affecting items disclosed separately in the financial statements (for example, misclassification between operating and nonoperating income or recurring and nonrecurring income items or a misclassification between restricted and unrestricted resources in a not-for-profit entity).
- offsets effects of individually significant but different misstatements.
- is currently immaterial and likely to have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.
- is too costly to correct. It may not be cost beneficial for the client 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.
- represents a risk that possible additional undetected misstatements would affect the auditor's evaluation.
- changes a loss into income or vice versa.
- heightens the sensitivity of the circumstances surrounding the misstatement (for example, the implications of misstatements involving fraud and possible instances of noncompliance with laws or regulations, violations of contractual provisions, and conflicts of interest).
- has a significant effect relative to reasonable user needs (for example,
  - — earnings to investors and the equity amounts to creditors,
  - — the magnifying effects of a misstatement on the calculation of purchase price in a transfer of interests [buy-sell agreement], and
  - — the effect of misstatements of earnings when contrasted with expectations).
- 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).
- 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).

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 the misstatement is material. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A29 Section 240 explains how the implications of a misstatement that is, or may be, the result of fraud are required to be considered with regard to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements.[19] Depending on the circumstances, misstatements in disclosures could also be indicative of fraud and, for example, may arise from the following:

- Misleading disclosures that have resulted from bias in management's judgments
- Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements

When considering the implications of misstatements in classes of transactions, account balances, and disclosures, the auditor exercises professional skepticism in accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.[20] [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A30 The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. Different acceptable approaches to the auditor's evaluation of such uncorrected misstatements on the current period's financial statements are available. Using the same evaluation approach provides consistency from period to period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities

.A31 In the case of an audit of a governmental entity, the evaluation of whether a misstatement is material also may be affected by the auditor's responsibilities established by law or regulation to report specific matters, including, for example, fraud. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A32 Furthermore, issues such as public interest, accountability, integrity, and ensuring effective legislative oversight, in particular, may affect the assessment of whether an item is material by virtue of its nature. This is particularly so for items that relate to compliance with law or regulation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

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[19]Paragraph .35 of section 240. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

[20]Paragraph .17 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Documentation (Ref: par. .12)

.A33 The auditor's documentation of uncorrected misstatements may take into account the following:

a. The consideration of the aggregate effect of uncorrected misstatements

b. The evaluation of whether the materiality level or levels for particular classes of transactions, account balances, or disclosures, if any, have been exceeded

c. The evaluation of the effect of uncorrected misstatements on key ratios or trends and compliance with legal, regulatory, and contractual requirements (for example, debt covenants)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

AU-C Sections 500–599

AUDIT EVIDENCE

AU-C Section 500

Audit Evidence

(Supersedes SAS No. 122 section 500)

Source: SAS No. 142; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2022.

Introduction

Scope of This Section

.01 This section explains what constitutes audit evidence in an audit of financial statements and sets out attributes of information that are taken into account by the auditor when evaluating information to be used as audit evidence. Taking these attributes into account assists the auditor in maintaining professional skepticism. (Ref: par. .A1)

.02 The application of this section assists the auditor in fulfilling the auditor's responsibilities in other AU-C sections. This section should be read in conjunction with other AU-C sections, including those that address the auditor's responsibilities to identify and assess the risks of material misstatement,[1] design and implement responses to the risks of material misstatement identified and assessed by the auditor,[2] and form an opinion on the financial statements.[3] In particular, section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained,* requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained and thereby provides a basis for the auditor's opinion. (Ref: par. .A2)

.03 The auditor's overall conclusion in accordance with section 330 about whether sufficient appropriate audit evidence has been obtained is a matter of professional judgment. Evaluating information to be used as audit evidence in accordance with this section assists the auditor in making that conclusion. The auditor's evaluation of information to be used as audit evidence is not a formulaic exercise and is dependent on the degree to which the attributes of information to be used as audit evidence influence the auditor's evaluation. (Ref: par. .A3–.A4)

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[1]See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[2]Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[3]Section 700, *Forming an Opinion and Reporting on Financial Statements*.

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2022.

Objective

.05 The objective of the auditor is to evaluate information to be used as audit evidence, including the results of audit procedures, to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained.

Definitions

.06 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

Appropriateness (of audit evidence). The measure of the quality of audit evidence, that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. (Ref: par. .A9)

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence is information to which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements. (Ref: par. .A5–.A10)

External information source. An external individual or organization that provides information that is used by the entity in preparing the financial statements or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of management's specialist, service organization,[4] or auditor's specialist,[5] the individual or organization is not considered an external information source with respect to that particular information.

Sufficiency (of audit evidence). The measure of the quantity of audit evidence. The quantity of audit evidence necessary is affected by the auditor's assessment of the risks of material misstatement and the quality of the audit evidence obtained (that is, its appropriateness). (Ref: par. .A9–.A10)

Requirements

Evaluating Information to Be Used as Audit Evidence

.07 The auditor should evaluate information to be used as audit evidence by taking into account (Ref: par. .A11)

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[4]See section 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

[5]See section 620, *Using the Work of an Auditor's Specialist*.

a. the relevance and reliability of the information, including its source, and (Ref: par. .A12–.A34)

b. whether such information corroborates or contradicts assertions in the financial statements. (Ref: par. .A35–.A38)

.08 The auditor's evaluation of the information to be used as audit evidence in accordance with paragraph .07 should include

a. evaluating whether the information is sufficiently precise and detailed for the auditor's purposes and (Ref: par. .A39)

b. obtaining audit evidence about the accuracy and completeness of the information, as necessary (Ref: par. .A40–.A42).

Audit Procedures as a Basis for Concluding on the Sufficiency and Appropriateness of Audit Evidence

.09 In evaluating information to be used as audit evidence, the auditor should consider whether the results of audit procedures provide a basis for concluding on the sufficiency and appropriateness of audit evidence obtained. (Ref: par. .A43–.A64)

Inconsistencies in, or Doubts About the Reliability of, Audit Evidence

.10 The auditor should determine whether modifications or additions to audit procedures are necessary to resolve inconsistencies in, or doubts about the reliability of, audit evidence, including when

a. audit evidence obtained from one source is inconsistent with that obtained from another source.

b. the results of an audit procedure are inconsistent with the results of another audit procedure.

(Ref: par. .A65–.A66)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.03)

.A1 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards,* defines *professional skepticism* and *professional judgment*.[6] Section 200 and section 330 provide application material about maintaining professional skepticism and exercising professional judgment.[7] The auditor's evaluation of information to be used as audit evidence in accordance with this section

[6] Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

involves maintaining professional skepticism, including the consideration of whether unconscious or conscious auditor biases may affect the auditor's professional judgments.[8] Paragraphs .A17, .A30–.A31, .A37–.A38, .A60, and .A63 of this section are examples of paragraphs that describe ways in which the auditor can maintain professional skepticism.

.A2 Paragraph .02 states that this section should be read in conjunction with other AU-C sections. For example, the objective of section 330 is for the auditor to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks.[9]Section 330 also states that the auditor is required to do the following:

- Design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.[10]
- Obtain more persuasive audit evidence the higher the auditor's assessment of risk.[11]
- Conclude whether sufficient appropriate audit evidence has been obtained.[12]
- Attempt to obtain further audit evidence if the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion.[13]

In addition, section 700, *Forming an Opinion and Reporting on Financial Statements*, requires the auditor to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusions required by section 700 take into account, among other things, whether sufficient appropriate audit evidence has been obtained in accordance with section 330.[14]

.A3 Audit evidence is cumulative in nature and is obtained through the performance of one or more audit procedures on information obtained during the course of the audit. The auditor's evaluation of information to be used as audit evidence may be enhanced by the use of automated tools and techniques, which may enable the auditor to aggregate or disaggregate information or consider information obtained from multiple sources.

.A4 For example, the auditor may use automated tools and techniques for the purpose of planning or performing the audit, such as audit data analytics. *Data analytics* is described as the analysis of patterns, identification of anomalies, or extraction of other useful information in data underlying or related to the subject matter of an audit through analysis,

[7]Paragraphs .A22–.A31 of section 200.

[8]See paragraph .A27 of section 200.

[9]Paragraph .03 of section 330.

[10]Paragraph .06 of section 330.

[11]Paragraph .07*b* of section 330.

[12]Paragraph .28 of section 330.

[13]Paragraph .29 of section 330.

[14]Paragraph .13*a* of section 700.

modeling, or visualization. Examples of other automated tools and techniques are artificial intelligence, machine learning, remote observation tools, and robotic process automation.

Definitions (Ref: par. .06)

Audit Evidence

.A5 *Audit evidence* is information to which audit procedures have been applied, ordinarily during the course of the current-year audit. Information to be used as audit evidence may also be obtained by the auditor as part of designing and performing risk assessment procedures in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, including from

a. the auditor's previous experience with the entity and audit procedures performed in previous audits, when the auditor has evaluated whether such information remains relevant and reliable as audit evidence for the current audit,

b. the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and

c. when applicable, other engagements performed by the engagement partner for the entity.

.A6 The nature of the audit procedures that the auditor performs to use information as audit evidence may depend on the source of the information and range from simple to extensive audit procedures. For example, when using information from an external information source, obtaining the information may be relatively straightforward, and the auditor's procedures to evaluate that information would be largely focused on the relevance and reliability of the information, including its source, in accordance with this section. On the other hand, audit procedures to obtain evidence about the accuracy and completeness of the information, such as tests of controls, may be necessary when the auditor intends to use information generated internally from the entity's general and subsidiary ledgers as audit evidence.

.A7 In some cases, the absence of information is used by the auditor and, therefore, also constitutes audit evidence.[15]For example, when considering information regarding management's assertions related to the entity's recorded warranty provision, the absence of sales returns of the product in question may be audit evidence supporting management's assertion about the completeness of the warranty provision.

Sufficient Appropriate Audit Evidence

.A8 As explained in section 200, reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.[16]

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[15]Paragraph .A32 of section 200.

.A9 As explained in section 200, the sufficiency and appropriateness of audit evidence are interrelated.[17]Together they affect the persuasiveness of audit evidence. The auditor's conclusion about whether sufficient appropriate audit evidence has been obtained in accordance with section 330 is both at the financial statement level as well as the relevant assertion level. Section 330 requires the auditor to obtain more persuasive audit evidence the higher the assessment of risk.[18]For example, ordinarily, more persuasive audit evidence is needed to respond to significant risks. *Persuasiveness*, therefore, relates to the auditor obtaining appropriate audit evidence that is sufficient for the auditor to draw reasonable conclusions.

.A10 The quantity of audit evidence, in and of itself, is not solely determinative of its persuasiveness. For example, obtaining more of the same type of audit evidence may not compensate for its lack of appropriateness. However, as the quality of audit evidence increases, the need for additional corroborating audit evidence decreases. Depending on the auditor's consideration of relevance and reliability, information obtained from a single source may provide persuasive audit evidence.

Evaluating Information to Be Used as Audit Evidence (Ref: par. .07–.08)

.A11 Information to be used as audit evidence may take different forms, which influences the nature of audit procedures that may be necessary to obtain or evaluate the information. Different forms of information, individually or in combination, include

- *oral information* obtained through a verbal response to an inquiry of management or external information sources (for example, oral inquiries made during the course of the audit).
- *visual information* obtained through observation (for example, a message that appears on-screen for a control restricting access to an IT) system or observed by the auditor using remote observation tools).
- *paper documents*, which are obtained in documentary form (for example, an original executed sales contract or a written confirmation).
- *electronic information*, which includes
  - — *documents* obtained in electronic documentary form (for example, a scanned version of an executed sales contract or an electronic confirmation).
  - — *data* stored in the entity's IT system or obtained electronically from an external information source. Such data may be manually input into the system or may be electronically generated (for example, an electronic data interface between the entity and a service organization).

[16]Paragraph .06 of section 200.

[17]Paragraph .A33 of section 200.

[18]See paragraph .07*b* of section 330.

Relevance and Reliability of the Information, Including Its Source (Ref: par. .07a)

Sources of Information to Be Used as Audit Evidence

.A12 The source of the information to be used as audit evidence often affects the consideration of its relevance and reliability. Information to be used as audit evidence may be obtained directly or derived individually or in combination from different sources, including the following:

a. *Management.* Management may provide the auditor with information obtained from the financial reporting process used to prepare the financial statements, including disclosures (for example, the entity's accounting records) as well as information obtained from outside of the general and subsidiary ledgers (for example, from the entity's risk management system or sales functions). This information may be stored by the entity within its IT systems or in a remote server. Management may also employ or engage a specialist who may provide information to be used as audit evidence.[19]

b. *External information sources and other external parties.* Management or the auditor may use information obtained from external information sources and other external parties (for example, information used as inputs to forecasts or models used to prepare accounting estimates or accumulated by an auditor to analyze industry trends). The auditor may obtain external confirmations or make inquiries of external parties to corroborate management's assertions. See appendix A, "Considerations Regarding the Use of External Information Sources," for the auditor's considerations when using external information sources.

c. *Auditor.* The auditor may develop information to be used as audit evidence. For example, an auditor may accumulate and analyze industry trends to be used in the audits of entities in that industry. The auditor may also employ or engage a specialist to assist the auditor in developing audit evidence, which could include developing an independent expectation to evaluate the reasonableness of an accounting estimate. The auditor may also use automated tools and techniques to analyze information provided by management or external parties, resulting in audit evidence.

.A13 Accounting records are an example of information provided by management that is obtained from the financial reporting process and may include the following:

- The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; and journal entries
- Records, such as spreadsheets, cost allocations, computations, reconciliations, and disclosures

[19]See section 501, *Audit Evidence — Specific Considerations for Selected Items*.

.A14 An example of information provided by management that is obtained from outside the general and subsidiary ledgers is internal marketing information developed by the entity's sales function as an assumption in making an accounting estimate for a warranty provision.

.A15 External confirmation[20] procedures may provide relevant information to be used as audit evidence when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to classes of transactions, account balances, or disclosures. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain conditions (for example, the absence of a side agreement that may influence revenue recognition).

.A16 As indicated in paragraph .A12, information to be used as audit evidence by the auditor may be obtained directly or derived individually or in combination from different sources. For example, in making an accounting estimate for an accumulated pension obligation, management may use information that is obtained from the general and subsidiary ledgers; information obtained from outside the general and subsidiary ledgers; and information obtained from a management's specialist. Similarly, an auditor may obtain information to be used as audit evidence from multiple sources. For example, in performing a regression analysis to test revenue recorded, the auditor may obtain information about square footage of retail space and sales prices (both management-generated) and changes in an index published by a government agency (an external information source).

.A17 In some situations, there may be only one source of certain information external to the entity, for example, information from a central bank or government, such as an inflation rate, or single recognized industry body. In such cases, taking into account the reliability of such information is influenced by the nature and credibility of the source of the external information, the assessed risks of material misstatement to which that external information is relevant, and the degree to which the use of that external information is relevant to the reasons for the assessed risk of material misstatement. For example, when the information is from a credible authoritative source, the extent of the auditor's further audit procedures may be less extensive, such as corroborating the information with the source's website or published information. In other cases, when information is from a source not assessed as credible, the auditor may determine that more extensive audit procedures are appropriate. In the absence of an alternative independent information source against which to compare, the auditor may consider whether performing additional audit procedures to obtain information from the external information source is appropriate in order to obtain sufficient appropriate audit evidence (see paragraph 9 in appendix A).

.A18 In certain circumstances, the source of information may be a combination of management and external parties. For example, if an entity develops a distributed ledger to capture its transactions, there may be few or many other external parties participating in the transactions and contributing to the information included in the distributed ledger. Therefore, the source of the information included in the distributed ledger is not solely

[20] See section 505, *External Confirmations*.

management but also external parties. In such circumstances, professional judgment is exercised by the auditor to evaluate the relevance and reliability of the information obtained from the distributed ledger to be used as audit evidence.

Relevance and Reliability

.A19 *Relevance*. The relevance of the information to be used as audit evidence relates to the logical connection with, or bearing upon, the auditor's purposes. Information from one source may be relevant when performing one or more audit procedures (for example, sales information provided by management may be used to perform procedures related to both the entity's warranty provision and evaluation of management's cash flows forecast related to the entity's warranty provision). The following are factors that, individually or in combination, may affect the relevance of information to be used as audit evidence:

- The classes of transactions, account balances, or disclosures or assertions to which the information relates. Information to be used as audit evidence may be relevant to multiple classes of transactions, account balances, or disclosures.
- The period of time to which the information relates.

.A20 The following examples illustrate the relevance of information to be used as audit evidence:

- Recorded accounts payable may provide relevant information when the objective of the audit procedures is to test the existence or valuation pertaining to accounts payable.
- Employee salaries may provide relevant information regarding an accounting estimate for a bonus accrual.
- Commodity pricing data may be used in the performance of an audit data analytic to evaluate recorded revenue. The period of time used for the commodity pricing data has to be relevant to the time period revenue was recorded.

.A21 Certain information to be used as audit evidence may have direct relevance to one financial statement assertion but may not be relevant to all assertions:

- Inspection of a document constituting a financial instrument, such as a stock, bond, or a digital copy of a mortgage, may provide relevant audit evidence about existence but may not necessarily provide audit evidence about ownership or valuation.
- Inspection of tangible assets may provide relevant audit evidence with respect to their existence but not necessarily about the entity's rights and obligations.
- The collection of receivables after the period-end may provide relevant audit evidence regarding existence and valuation of receivables and occurrence and accuracy of revenue but not necessarily completeness of receivables and revenue.

.A22 *Reliability*. The reliability of audit evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias. Consideration of the sources of information to be used as audit evidence includes the possibility that the information source may not be reliable.

.A23 Information obtained directly by the auditor (for example, observation of the application of a control) may be more reliable than information obtained indirectly or by inference (for example, inquiry about the application of a control). When information has been obtained indirectly or by inference, the auditor may perform additional audit procedures to evaluate the reliability of that information, such as by reperforming the control activity.

.A24 Information in documentary form, whether paper or electronic, may be more reliable than evidence obtained through oral inquiries (for example, a contemporaneously written record of a meeting may be more reliable than a subsequent oral representation of the matters discussed).

.A25 Determining whether controls are effectively designed and implemented (including general IT controls, as appropriate) may help the auditor design appropriate audit procedures to evaluate the reliability of information.[21]In some cases, the reliability of such information may only be established when the related controls, whether manual or automated, including those over the preparation and maintenance of the information, have been tested and determined to be operating effectively.[22]

.A26 Using electronic information may require the auditor to perform additional audit procedures to establish its reliability. For example, when using a scanned version of an executed sales contract provided by the sales department, additional audit procedures, such as confirmation of the key terms with a third party, may be necessary if the auditor has not tested the operating effectiveness of the controls around execution of the original contract and the maintenance of the scanned version.

.A27 The reliability of information to be used as audit evidence is affected to varying degrees by the following attributes, individually or in combination:

- Accuracy
- Completeness
- Authenticity
- Susceptibility to management bias

These attributes are also relevant when automated tools and techniques are used to obtain audit evidence.

.A28 *Controls Over Information to Be Used as Audit Evidence*. When information has been transformed from its original medium (for example, documents that have been filmed,

[21]See paragraph .07 of this section.

[22]See also paragraph .05*b* of section 520, *Analytical Procedures*.

digitized, or otherwise transformed to electronic form), the reliability of that information may depend on the controls over the information's transformation and maintenance. In some situations, the auditor may determine that additional audit procedures are necessary to address reliability (for example, inspecting underlying original documents to validate the authenticity of information in electronic form). In other situations, the auditor may determine that it is necessary to test controls over the transformation and maintenance of the information.

.A29 Similarly, when a significant amount of information is electronically initiated, recorded, processed, or reported, information to be used as audit evidence may be available only in electronic form. In such cases, the sufficiency and appropriateness of the audit evidence usually depends on the effectiveness of controls over their accuracy and completeness. Furthermore, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is initiated, recorded, processed, or reported only in electronic form, and appropriate controls are not operating effectively.

.A30 *Authenticity*. An audit performed in accordance with GAAS rarely involves the authentication of documents, nor is the auditor trained as, or expected to be, an expert in such authentication. When the auditor identifies conditions that cause the auditor to believe that a document may not be authentic, that terms in a document may have been modified but not disclosed to the auditor, or that undisclosed side agreements may exist, the auditor may determine that additional audit procedures are necessary, including audit procedures to evaluate authenticity. Such audit procedures may include

- confirming directly with the third party.
- using the work of a specialist to assess the document's authenticity.[23]

.A31 *Susceptibility to Management Bias*. Information with a higher susceptibility to management bias is considered less reliable than information for which the susceptibility to management bias is lower unless audit procedures have been performed to address the higher susceptibility to management bias.

.A32 A susceptibility to management bias may exist in the development of information itself or may exist due to interpretation of the information by the entity. A greater susceptibility to management bias may exist when information is generated from internal sources.

.A33 In accordance with section 200, the auditor is required to exercise professional judgment.[24]This includes determining the impact of management bias in evaluating the reliability of information from external information sources to be used as audit evidence. Determining the effect of management bias involves considering the following:

a. The ability of the entity to influence the external information source

[23]Paragraph .A11 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

[24]Paragraph .18 of section 200.

b. Management's selection of information from an external source known to be favorably biased toward corroborating management's assertions or information

.A34 External information is more likely to be suitable for use by a broad range of users and less likely to be subject to influence by any particular user if the external individual or organization provides it to the public for free or makes it available to a wide range of users in return for payment of a fee.

*Corroborative or Contradictory Information (Ref: **par. .07b**)*

.A35 Section 330 states that, in forming a conclusion about whether sufficient appropriate audit evidence has been obtained, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions being tested by the auditor or the amounts recorded in the financial statements.[25]

.A36 Evaluating information to be used as audit evidence involves taking into account information that corroborates assertions or contradicts assertions in the financial statements. For example, audit evidence obtained through the inspection of an original document may corroborate a financial statement assertion, whereas audit evidence obtained from confirmation with an external party may contradict that financial statement assertion. In this example, additional audit evidence may be necessary to enable the auditor to conclude on the relevant assertion.

.A37 Contradictory information may be relevant even when the source of that information is less reliable than the source of corroborative information. For example, in the audit of a depository institution, reports of decreasing property values in a particular geographical area may have been obtained by the auditor that contradicted the report of an external appraisal provided by management to support its estimate of the values of collateral for a loan portfolio. In this case, given that contradictory information has been obtained, the auditor may determine that it is necessary to perform additional audit procedures to obtain audit evidence about the value of the property.

.A38 Contradictory information is not considered in isolation but, rather, as part of the auditor's consideration with respect to that management assertion taken as a whole. In such cases, professional skepticism and judgment is necessary to evaluate the persuasiveness of the audit evidence taken as a whole, rather than focusing on an individual piece of audit evidence. For example, the auditor may be aware of information on social media suggesting a company's product has major quality issues and that all buyers would be returning the product. The auditor may have obtained external confirmations regarding product sales and outstanding accounts receivable that do not indicate quality or return issues and may have scanned the sales returns subsidiary ledger, which contained only an immaterial amount of returns subsequent to year-end. In light of that, the auditor may conclude that the contradictory information does not suggest a reasonable possibility of a risk of material misstatement and that further audit procedures are not necessary.

[25] Paragraph .28 of section 330.

Evaluating Whether the Information Is Sufficiently Precise and Detailed for the Auditor's Purposes (Ref: par. 08a)

.A39 In some cases, the auditor may intend to use information obtained from management for other audit purposes. For example, the auditor may use the performance measures included in the entity's internal audit function reports, initially obtained for the purpose of evaluating monitoring activities, in a substantive analytical procedure. In such cases, the appropriateness of this information to be used as audit evidence is affected by whether the information is sufficiently precise or detailed for the auditor's purposes.

Accuracy and Completeness (Ref: par. .08b)

.A40 In accordance with paragraph 8, the auditor is required to determine whether it is necessary to obtain audit evidence about the accuracy and completeness of information to be used as audit evidence. Examples of this would be the reliability of

- the price and sales volume data produced by the entity used to develop an expectation of revenue is affected by the accuracy and completeness of the information being used.
- a population being tested for a certain characteristic, such as payment authorization, is affected by the completeness of the population from which items are selected.

.A41 The auditor may obtain audit evidence about the accuracy or completeness of information to be used as audit evidence through the performance of an audit procedure that was not primarily intended for that purpose. For example, in testing valuation, the auditor may reconcile the listing of investment purchases for completeness before selecting a sample. In other situations, the auditor may consider it necessary to obtain audit evidence about the accuracy and completeness of information by testing controls over the preparation and maintenance of the information (for example, in light of the nature, frequency, and volume of transactions).

.A42 In contrast to paragraph .A41, evaluating certain attributes related to the relevance and reliability of information obtained from external information sources, such as completeness, used by the auditor may not be practicable. Procedures regarding the reliability of external information may depend on how the external information will be used in the execution of an audit procedure because the auditor may not be able to evaluate the completeness and accuracy of information obtained from an external source to the same degree as the auditor would evaluate the completeness and accuracy of internal information obtained from management. For example, when using information from external information sources to perform an audit data analytic, the auditor's evaluation may focus more on the quality of that information (for example, that the information was from a reputable source), rather than its completeness.

Audit Procedures as a Basis for Concluding on the Sufficiency and Appropriateness of Audit Evidence (Ref: par. .09)

.A43 Audit procedures performed on information may include inspection, observation, confirmation, recalculation, reperformance, and analytical procedures, often in some combination, in addition to inquiry. These audit procedures may be performed either manually or using automated tools and techniques. The nature, timing, and extent of audit procedures performed on information influences the persuasiveness of the audit evidence obtained. For example, inspection or observation may provide more persuasive audit evidence than inquiry.

.A44 As explained further in section 315A and section 330, to draw reasonable conclusions on which to base the auditor's opinion, audit evidence is obtained by performing the following:[26,27]

a. Risk assessment procedures

b. Further audit procedures, which comprise

    i. tests of controls, when required by the AU-C sections or when the auditor has chosen to do so, and

    ii. substantive procedures, which include tests of details and substantive analytical procedures

An audit procedure may have characteristics of one or more of the preceding categories and can be designed to accomplish more than one objective. The auditor's focus is on evaluating the results of the audit procedures performed.

.A45 The auditor may use automated tools and techniques to process, organize, structure, or present data in a given context in order to generate useful information that can be used as audit evidence.

.A46 An auditor may use automated tools and techniques to perform both a risk assessment procedure and a substantive procedure concurrently. As illustrated by the concepts in exhibit A, a properly designed audit data analytic may be used to perform risk assessment procedures and may also provide sufficient appropriate audit evidence to address a risk of material misstatement.

.A47 The auditor may also use automated tools and techniques to obtain audit evidence about the operation of the entity's internal control. For example, if management has controls over the sequential numbering of sales invoices, the auditor may be able to obtain corroborating audit evidence about the sequential numbering of sales invoices for the period by using automated tools and techniques to determine whether any gaps in numbering or duplicates exist, which may provide audit evidence about the controls over the completeness of invoices issued during the period.

.A48 Some information may be available only in electronic form or only at certain points or periods in time, which may affect the nature and timing of the audit procedures to be performed.

[26] Paragraphs .05–.06 of section 315A.

[27] Paragraphs .06–.07 of section 330.

.A49 Certain electronic information may be destroyed or deleted after a specified period of time (for example, if files are changed and back-up files do not exist). Accordingly, as a result of the entity's data retention policies, the auditor may find it necessary to request retention of some information for the performance of audit procedures at a later point in time or to perform audit procedures at a time when the information is available.

.A50 Some electronic information (for example, records maintained on a distributed ledger, such as a blockchain) is available on a continuous basis during the audit. In such cases, auditors may develop audit procedures using automated tools and techniques to obtain information about transactions on a real-time basis.

Inspection

.A51 Inspection involves an examination (being physically present or using remote observation tools) of an asset or an examination of records or documents, whether internal or external or in paper form, electronic form, or other media. An example of inspection used as a test of controls is inspection of records, using manual or automated techniques, for evidence of authorization. An example of an automated technique for inspection is the use of text-recognition programs to examine large populations of documents, such as contracts, to identify items for further audit consideration.

Observation

.A52 Observation includes looking at a process or procedure being performed by others (for example, the auditor's observation of inventory counting by the entity's personnel or the performance of control activities).

.A53 Remote observation tools (for example, a camera mounted on a drone or a video transmission) may aid the auditor in performing an inspection or an observation procedure, such as management's physical inventory count.

.A54 Audit evidence obtained through observation procedures is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.

Confirmation

.A55 An external confirmation is defined as audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium (for example, through the auditor's direct access to information held by a third party). See section 505, *External Confirmations*, for further guidance.

Recalculation

.A56 Recalculation consists of testing the mathematical accuracy of information. Recalculation may be performed manually or using automated tools and techniques.

.A57 By using automated tools and techniques, auditors may be able to perform recalculation procedures on 100% of a population, for example, recalculating the gross margin for each product sold for an entity's product line.

Reperformance

.A58 Reperformance involves the independent execution of procedures or controls by the auditor that were originally performed as part of the entity's internal control.

Analytical Procedures

.A59 Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass investigation as necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. Audit data analytics are techniques that the auditor may use to perform risk assessment procedures or substantive procedures.

.A60 Use of audit data analytics may enable auditors to identify areas that might represent specific risks relevant to the audit, including the existence of unusual transactions and events, and amounts, ratios, and trends that warrant investigation. An analytical procedure performed using audit data analytics may be used to produce a visualization of transactional detail to assist the auditor in performing risk assessment procedures. For example, a visualization depicting the composition of a population may be prepared to illustrate the volume and dollar value of items in the population. Although the auditor may find this technique useful in obtaining information in order to identify and assess the risks of material misstatement, the information provided may not be sufficiently precise for the auditor's purpose of obtaining information to respond to the assessed risks of material misstatement at the assertion level.

.A61 Analytical procedures involve the auditor's exercise of professional judgment and may be performed manually or by using automated tools and techniques. For example, the auditor may manually scan data to identify significant or unusual items to test, which may include the identification of unusual individual items within account balances or other data through the reading or analysis of entries in transaction listings, subsidiary ledgers, general ledger control accounts, adjusting entries, suspense accounts, reconciliations, and other detailed reports for indications of misstatements that have occurred. The auditor also might use automated tools and techniques to scan an entire population of transactions and identify those transactions meeting the auditor's criteria for a transaction being unusual. The identification of items that exhibit characteristics of risk of material misstatement through analytical procedures provides the auditor with audit evidence about those items. Analytical procedures also provide audit evidence about the items not exhibiting characteristics of risks of material misstatements because the auditor has determined, exercising professional judgment, that the items not selected for further audit procedures are less likely to be materially misstated.

Inquiry

.A62 Inquiry consists of seeking information, both financial and nonfinancial, from knowledgeable persons within the entity or outside the entity. Inquiry is used extensively throughout the audit, in addition to other audit procedures.

.A63 Responses to inquiries may provide the auditor with information that corroborates other information or with new information. Alternatively, responses might provide information that contradicts other information that the auditor has obtained (for example, regarding the possibility of management override of controls). Responses to inquiries may provide a basis for the auditor to modify or perform additional audit procedures. Evaluating responses to inquiries is an integral part of the inquiry process.

.A64 Inquiries of knowledgeable persons outside the entity do not meet the definition of *external confirmations* in accordance with section 505. However, the responses to inquiries of persons outside of the entity are considered in accordance with this section and may constitute reliable information to be used as audit evidence.

Inconsistencies in, or Doubts About the Reliability of, Audit Evidence (Ref: par. .10)

.A65 Information obtained from different sources may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another. This may be the case when, for example, an external confirmation is inconsistent with the terms of a debt obligation. Section 230, *Audit Documentation*, includes a specific documentation requirement if the auditor identifies information that is inconsistent with the auditor's final conclusion regarding a significant finding or issue.[28]

.A66 In the case of inquiries about management's intent, the information available to support management's intent may be limited.[29]Section 580, *Written Representations*, provides guidance about obtaining written representations that address management's intent. Maintaining professional skepticism is particularly important when corroborative audit evidence is limited to inquiry. In such circumstances, it may be helpful to consider the consistency, or lack thereof, between the information obtained through inquiry and management's history of carrying out its stated intentions, management's stated reasons for choosing a course of action, and management's ability to pursue a specific course of action.

[28]Paragraph .12 of section 230, *Audit Documentation*.

[29]Paragraph .A13 of section 580, *Written Representations*.

Appendix A — Considerations Regarding the Use of External Information Sources (Ref: par. .A12*b*)

.A67

1. As defined in paragraph 6 of this section, an *external information* source is an external individual or organization that provides information used by the entity in preparing the financial statements or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users.

2. External information sources may include pricing services, governmental organizations, central banks, recognized stock exchanges, media, or academic journals. Examples of information that may be obtained from external information sources include the following:

   - Prices and pricing-related data
   - Macroeconomic data, such as historical and forecast unemployment rates and economic growth rates, or census data
   - Credit history data
   - Industry-specific data, such as an index of reclamation costs for certain extractive industries or viewership information or ratings used to determine advertising revenue in the entertainment industry
   - Mortality tables used to determine liabilities in the life insurance and pension sectors
   - Documents or records on websites or in databases or distributed ledgers

3. As set forth in generally accepted auditing standards, an external individual or organization cannot, in respect of any particular set of information, be both an external information source and

   - a management's specialist,
   - a service organization, or
   - an auditor's specialist.

4. However, an external individual or organization may, for example, be acting as a management's specialist when providing a particular set of information but acting as an external information source when providing a different set of information. Professional judgment may be needed to determine whether an external individual or organization is acting as an external information source or as a management's specialist with respect to a particular set of information. The following examples illustrate some of the considerations that may be used. Each situation may be influenced by individual facts and circumstances:

   - An external individual or organization may be providing information about real estate prices that is suitable for use by a broad range of users, for example, information made generally available pertaining to a geographical region, and determined to be an external information source with respect to that set of information. The same external organization may also be acting as a management's or auditor's specialist in providing commissioned valuations, with respect to the entity's real estate portfolio specifically tailored for the entity's facts and circumstances.

- Some actuarial organizations publish mortality tables for general use that, when used by an entity, would generally be considered to be information from an external information source. The same actuarial organization may also be a management's specialist with respect to different information tailored to the specific circumstances of the entity to help management determine the pension liability for several of the entity's pension plans.
- An external individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the external individual or organization applies that expertise in making an estimate specifically for the entity and that work is used by management in preparing its financial statements, the external individual or organization is likely to be a management's specialist with respect to that information. If, on the other hand, that external individual or organization merely provides, to the public, prices or pricing-related data regarding private transactions, and the entity uses that information in its own estimation methods, the external individual or organization is likely to be an external information source with respect to such information.
- An external individual or organization may publish information, suitable for a broad range of users, about risks or conditions in an industry. If used by an entity in preparing its risk disclosures (for example, in compliance with FASB *Accounting Standards Codification* 275, *Risk and Uncertainties*), such information would ordinarily be considered to be information from an external information source. However, if the same type of information has been specifically commissioned by the entity to use its expertise to develop information about those risks, tailored to the entity's circumstances, the external individual or organization is likely to be acting as a management's specialist.
- An external individual or organization may apply its expertise in providing information about current and future market trends, which it makes available to, and is suitable for use by, a broad range of users. If used by the entity to help make decisions about assumptions to be used in making accounting estimates, such information is likely to be considered to be information from an external information source. If the same type of information has been commissioned by the entity to address current and future trends relevant to the entity's specific facts and circumstances, the external individual or organization is likely to be acting as a management's specialist.

5. The auditor is required by paragraph 7 of this section to take into account the relevance and reliability of information to be used as audit evidence regardless of

whether that information has been used by the entity in preparing the financial statements or was obtained by the auditor. For information obtained from an external information source, that consideration may, in certain cases, include

- information about the external information source,
- details about the preparation of the information by the external information source, or
- audit evidence obtained through designing and performing further audit procedures in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained,* or, where applicable, section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

6. Obtaining an understanding of why management or, when applicable, a management's specialist uses an external information source, and how the relevance and reliability of the information was taken into account (including its accuracy and completeness), may help inform the auditor's consideration of relevance and reliability of that information.

7. The following factors may be important when taking into account the relevance and reliability of information obtained from an external information source, including its accuracy and completeness. Some of these factors may only be relevant when the information has been used by management in preparing the financial statements or has been obtained by the auditor:

   - The nature and authority of the external information source (for example, a central bank or government statistics office with a legislative mandate to provide industry information to the public may be considered a reliable external information source for certain types of information.)
   - The ability of management to influence the information obtained, through relationships between the entity and the external information source
   - The competence and reputation of the external information source with respect to the information, including whether, in the auditor's professional judgment, the information is routinely provided by an external information source with a track record of providing reliable information
   - Past experience of the auditor with the reliability of the information provided by the external information source
   - Evidence of general market acceptance by users of the relevance or reliability of information from an external information source for a similar purpose to that for which the information has been used by management or the auditor
   - Whether the entity has in place controls to address the relevance and reliability of the information obtained and used
   - Whether the external information source accumulates overall market information or engages directly in "setting" market transactions

- Whether the information is suitable for use in the manner in which it is being used and, if applicable, was developed taking into account the applicable financial reporting framework
- Alternative information that may contradict the information used
- The nature and extent of disclaimers or other restrictive language relating to the information obtained[1]
- Information about the methods used in preparing the information; how the methods are being applied including, where applicable, how models have been used in such application; and the controls over the methods
- When available, information relevant to considering the appropriateness of assumptions and other data applied by the external information sources in developing the information obtained

8. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement, and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph 5 of this appendix, the auditor may determine that

   a. further understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control, is needed, in accordance with Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, or

   b. further audit procedures, in accordance with section 330[2] and section 540,[3] when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement at the assertion level related to the use of information from an external information source. Such audit procedures may include the following:

      i. Performing a comparison of information obtained from the external information source with information obtained from an alternative independent information source

      ii. When relevant to considering management's use of an external information source, obtaining an understanding of controls management has in place to consider the reliability of the information

[1]Paragraphs .A56–.A62 of section 501, *Audit Evidence — Specific Considerations for Selected Items*.

[2]Paragraph .06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[3]Paragraphs .12–.14 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

from external information sources and potentially testing the operating effectiveness of such controls

iii. Performing procedures to obtain information from the external information source to understand its processes, techniques, and assumptions, for the purposes of identifying, understanding, and when relevant, testing the operating effectiveness of its controls

9. When the auditor does not have a sufficient basis upon which to consider the relevance and reliability of information from an external information source, the auditor may have a limitation on scope if sufficient appropriate audit evidence cannot be obtained through alternative procedures. Any imposed limitation on scope is evaluated in accordance with the requirements of section 705, *Modifications to the Opinion in the Independent Auditor's Report.*

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Exhibit A — Using ADAs to Simultaneously Accomplish Multiple Audit Procedures (Ref: par. A46 and par. A61)

.A68

This exhibit illustrates the use of an audit data analytic (ADA) that simultaneously accomplishes the objectives of both risk assessment and substantive audit procedures.

Background

The fact pattern in this example, in which the auditor uses a revenue transaction scoring model, will focus on the audit of an entity that recognizes revenue when control of the product (or satisfaction of the performance obligation) transfers at a specific point in time,[1] such as a manufacturer of external data storage devices.

For purposes of this example, assume the following:

- Revenue was determined to be a material account during initial planning and scoping with the occurrence (including cut-off) and accuracy assertions being more susceptible to misstatement.
- The ADA was performed after initial planning and scoping as part of the ongoing and iterative risk assessment process.
- All transactions within the account were subject to the same processes and controls.
- The purpose of the ADA was to design the nature, timing, and extent of the audit procedures and to obtain audit evidence.
- Based on the understanding of controls, the auditor has concluded that the controls over revenue were effectively designed and have been implemented, the auditor has tested certain relevant controls and determined they are operating effectively, and the auditor is otherwise satisfied the entity has appropriately applied the requirements of the applicable financial reporting framework (for example, FASB *Accounting Standards Codification* (ASC) 606, *Revenue from Contracts with Customers*).
- Data used in the ADA are relevant and reliable and have been tested for accuracy and completeness.
- Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas.
- Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month.
- The customer base does not fluctuate significantly from period to period.

[1]FASB *Accounting Standards Codification* 606-10-25-30.

- Revenue is recognized when control transfers at a free-on-board (FOB) shipping point.
- Invoicing occurs the day the product ships from the entity's warehouse.
- Warehouse personnel typically do not work weekends.
- The company does not sell product to any related parties.

All items that are determined to be individually material were excluded from the ADA and substantively tested separately. The remaining population that was subject to the ADA comprised routine, non-complex transactions with third parties. The processing and recording of transactions are highly automated and less likely to be susceptible to management override.

Description of the ADA

ADA Scoring Model — A complete population of transactions (at the individual item level) for one material account (excluding individually significant items) was subjected to an ADA designed to identify and assess risk and obtain audit evidence specific to a relevant assertion using different routines. The scoring of each routine is based on the evidence expected to be provided by that routine in relation to the auditor's assessment of the risks of material misstatement.

The routines were as follows:

Routine	Description	Characteristic	Transaction Scoring Model	Risk Score	Relevant Fact Pattern
1	Identify customers with infrequent revenue activity (less than X transactions)	Volume	Less than 6 transactions	2	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month
			6–12 transactions	1	Some customers only purchase in bulk a few times a year, whereas others purchase smaller quantities one to two times a month.
			More than 12 transactions	0	
2	Identify customers with a significant fluctuation in volume of products purchased (item level) on a period-over-period basis	Volume	Greater than 70% variance	2	Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas.
			30% to 70% variance	1	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month.
			Less than 30% variance	0	
3	Identify activity for new customers	Volume	Customer for 6 months or less	1	The customer base does not fluctuate significantly from period to period.
			Customer for greater than 6 months	0	
4	Identify all transactions recorded within X days of quarter-end.	Timing	Within 3 days of quarter end	1	Revenue is recognized when control transfers at FOB shipping point.
			Greater than 3 days of quarter end	0	
5	Identify revenue transactions with an invoice date on an unusual date (for example,	Timing	Transaction on a weekend/holiday	2	Invoicing occurs the day the product ships from the company's warehouse.

Routine	Description	Characteristic	Transaction Scoring Model	Risk Score	Relevant Fact Pattern
	weekend or holiday)				
			Transaction on a weekday	0	Warehouse personnel typically do not work weekends.
6	Identify instances in which the shipping document date and invoice date do not match.	Timing	Invoice and shipping document do not match, and invoice date is before shipping date.	4	Revenue is recognized when control transfers at FOB shipping point.
			Invoice and shipping document do not match, and shipping date is before invoice date.	2	Invoicing occurs the day the product ships from the company's warehouse.
			Invoice and shipping document match.	0	

Running the revenue transaction level detail through the ADA routines produces a total score for each transaction. The auditor then groups each transaction into a sub-population based on the individual transaction score. The number of sub-populations may differ depending upon the type of ADA developed, the scores produced by the ADA, and the auditor's assessment of those scores. For purposes of this example, the auditor grouped the population of the account into sub-populations as follows:

Assessed Risk	Total Risk Score	Group
High risk	8–12	A
Moderate risk	4–7	B
Low risk	0–3	C

- Group A – High risk — Comprises items with characteristics deemed to present a higher risk of material misstatement.

  Approach — The auditor would perform additional substantive procedures to provide more persuasive audit evidence for the items identified by the ADA. For example, the nature of the substantive procedure may be confirmation as opposed to inspection; the extent of testing may be greater (larger proportionate sample size); or the timing of the procedure may be at or near the financial statement date as opposed to earlier in the period.

- Group B – Moderate risk — Comprises items that warrant further procedures but do not have characteristics of those in the higher risk group.

  Approach — The auditor would perform substantive procedures appropriate for the items identified by the ADA in less depth relative to the higher risk population. For example, the nature of the substantive procedure may be limited to inspection of documents and records; the extent of testing may be less (smaller proportionate sample size); and the timing of the procedure may be earlier in the period.

- Group C – Low risk — Comprises items that demonstrate no unusual characteristics based on the procedure performed using the ADA.

  Approach — The results of other audit procedures performed throughout the audit would be evaluated for contradictory information regarding the assessed risk of material misstatement. In the absence of contradictory information, as the routines of the ADA are sufficiently precise for the auditor to conclude that the risks of material misstatement have been addressed, no additional substantive procedures may be warranted for any reason other than to incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.

As a result of the previous procedures, the auditor concluded

- Groups A, B, and C comprise a material account in the aggregate for which each group has differing risks.
- for Group C, the audit evidence provided over the transactions (within the population analyzed by the ADA in combination with the audit evidence provided by testing of certain key controls over revenue as determined by the auditor and the absence of contradictory audit evidence from the testing of related accounts) was sufficiently persuasive for the auditor to conclude that the risk of material misstatement was addressed.
- for Groups A and B, the audit evidence provided by the ADA was not sufficiently persuasive, and further substantive procedures were required to address the risk of material misstatement.

AU-C Section 9500

Audit Evidence: Auditing Interpretations of Section 500

1. The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals

.01 *Question*—The IRS's audit manual instructs its examiners on how to secure from corporate officials "tax accrual workpapers" or the "tax liability contingency analysis," including "a memorandum discussing items reflected in the financial statements as income or expense where the ultimate tax treatment is unclear." The audit manual states that the examiner may question or summons a corporate officer or manager concerning the "knowledge of the items that make up the corporation's contingent reserve accounts." It also states that "in unusual circumstances, access may be had to the audit or tax workpapers" of an independent accountant or an accounting firm after attempting to obtain the information from the taxpayer. IRS policy also includes specific procedures to be followed in circumstances involving "listed transactions," to help address what the IRS considers to be abusive tax avoidance transactions (Internal Revenue Manual, section 4024.2-.5, 5/14/81, and Internal Revenue Service Announcement 2002-63, 6/17/02).

.02 Concern over IRS access to tax accrual working papers might cause some entities to not prepare or maintain appropriate documentation of the calculation or contents of the accrual for income taxes included in the financial statements or to deny the independent auditor access to such information.

.03 What effect does this situation have on the auditor's opinion on the financial statements?

.04 *Interpretation*—The entity is responsible for its tax accrual, the underlying support for the accrual, and the related disclosures. Limitations on the auditor's access to information considered necessary to audit the tax accrual will affect the auditor's ability to issue an unmodified opinion on the financial statements.

.05 The auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.[1]

.06 If the entity does not have appropriate documentation of the calculation or contents of the accrual for income taxes and denies the auditor access to entity personnel responsible for making the judgments and estimates relating to the accrual, the auditor is required to conclude whether sufficient appropriate audit evidence has been obtained. If the auditor has

[1] Paragraph .06 of section 500, *Audit Evidence*.

not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor is required to attempt to obtain further audit evidence.[2]

.07 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements.[3]

.08 If the entity has appropriate documentation but denies the auditor access to it and to entity personnel who possess the information, the auditor is required to perform procedures to evaluate the consequence of an inability to obtain sufficient appropriate audit evidence due to a management-imposed limitation.[4]

.09 The auditor is required to request management to provide a written representation that it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement.[5] If management does not provide the written representations required by section 580, *Written Representations*, the auditor is required to disclaim an opinion on the financial statements in accordance section 705, *Modifications to the Opinion in the Independent Auditor's Report*, or withdraw from the engagement.[6]

.10 *Question*—An entity may allow the auditor to inspect its tax accrual workpapers but request that copies not be retained for audit documentation, particularly copies of the tax liability contingency analysis. The entity also may suggest that the auditor not prepare and maintain similar documentation of his or her own. What are the auditor's requirements in deciding a response to such a request?

.11 *Interpretation*—Section 230, *Audit Documentation*, defines *audit documentation* as the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.[7] The auditor is required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

a. the nature, timing, and extent of the audit procedures performed to comply with generally accepted auditing standards and applicable legal and regulatory requirements;

b. the results of the audit procedures performed and the audit evidence obtained; and

c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant judgments made in reaching those conclusions.[8]

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[2]Paragraphs .28–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[3]Paragraphs .08 and .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[4]Paragraphs .11–.14 of section 705.

[5]Paragraph .11*a* of section 580, *Written Representations*.

[6]Paragraph .25 of section 580.

[7]Paragraph .06 of section 230, *Audit Documentation*.

[8]Paragraph .08 of section 230.

Section 500, *Audit Evidence*, states that other information includes information obtained by the auditor from inquiry, observation, inspection, and physical examination. The quantity, type, and content of audit documentation are matters of the auditor's judgment.

.12 The audit documentation of the results of auditing procedures directed at the tax accounts and related disclosures also includes sufficient appropriate audit evidence about the significant elements of the entity's tax liability contingency analysis. This audit documentation includes copies of the entity's documents, schedules, or analyses (or auditor-prepared summaries thereof) to enable the auditor to support his or her conclusions regarding the appropriateness of the entity's accounting and disclosure of significant tax-related contingency matters. The audit documentation reflects the procedures performed and conclusions reached by the auditor and, for significant matters, include the entity's documentary support for its financial statement amounts and disclosures.

.13 The audit documentation includes the significant elements of the entity's analysis of tax contingencies or reserves, including roll-forward of material changes to such reserves. In addition, the audit documentation provides the entity's position and support for income tax related disclosures, such as its effective tax rate reconciliation, and support for its intraperiod allocation of income tax expense or benefit to continuing operations and to items other than continuing operations. When applicable, the audit documentation also includes the entity's basis for assessing deferred tax assets and related valuation allowances and its support for applying the "indefinite reversal criteria" discussed in FASB ASC 740-30-25-17, including its specific plans for reinvestment of undistributed foreign earnings.

.14 *Question*—In some situations, an entity may furnish its external legal counsel or in-house legal or tax counsel with information concerning the tax contingencies covered by the accrual for income taxes included in the financial statements and ask counsel to provide the auditor an opinion on the adequacy of the accrual for those contingencies.

.15 In such circumstances, rather than inspecting and obtaining documentary evidence of the entity's tax liability contingency analysis and making inquiries of the entity, may the auditor consider the counsel as a management's specialist within the meaning of section 500 and rely solely on counsel's opinion as an appropriate procedure for obtaining audit evidence to support his or her opinion on the financial statements?

.16 *Interpretation*—No. The opinion of legal counsel in this situation does not provide sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the financial statements. The opinion of legal counsel on specific tax issues that he or she is asked to address and to which he or she has devoted substantive attention, as contemplated by the legal counsel's response to an auditor's letter of inquiry, can be useful to the auditor in forming his or her own opinion.

.17 An opinion from an entity's legal or tax counsel, similar to other work products obtained from a management's specialist, is useful in situations in which the auditor does not have adequate technical training and proficiency. In this case, however, the auditor's education, training, and experience, on the other hand, do enable him or her to be knowledgeable concerning income tax matters and competent to assess their presentation in the financial statements.

.18 Therefore, while the opinion of legal counsel on specific tax issues can be useful to the auditor in forming his or her own opinion, the audit of income tax accounts requires a combination of tax expertise and knowledge about the entity's business that is accumulated during all aspects of an audit. Therefore, as previously stated, it is not appropriate for the auditor to rely solely on such legal opinion.

.19 *Question*—A entity may have obtained the advice or opinion of an outside tax adviser related to the tax accrual or matters affecting it, including tax contingencies, and further may attempt to limit the auditor's access to such advice or opinion, or limit the auditor's documentation of such advice or opinion. This limitation on the auditor's access may be proposed on the basis that such information is privileged. Can the auditor rely solely on the conclusions of third-party tax advisers? What audit evidence should the auditor obtain and include in the audit documentation?

.20 *Interpretation*—As discussed in paragraphs .16–.18 of this interpretation, the auditor cannot accept an entity's or a third party's analysis or opinion with respect to tax matters without careful consideration and application of the auditor's tax expertise and knowledge about the entity's business. As a result of applying such knowledge to the facts, the auditor may encounter situations in which the auditor either disagrees with the position taken by the entity, or its advisers, or does not have sufficient appropriate audit evidence to support his or her opinion.

.21 If the entity's support for the tax accrual or matters affecting it, including tax contingencies, is based upon an opinion issued by an outside adviser with respect to a potentially material matter, the auditor is required to obtain access to the opinion,[9] notwithstanding potential concerns regarding attorney-client or other forms of privilege. The audit documentation includes either the actual advice or opinions rendered by an outside adviser or other sufficient documentation or abstracts supporting both the transactions or facts addressed as well as the analysis and conclusions reached by the entity and adviser. Alternatives such as redacted or modified opinions may be considered but must, nonetheless, include sufficient content to articulate and document the entity's position so that the auditor can formulate his or her conclusion. Similarly, it may be possible to accept an entity's analysis summarizing an outside adviser's opinion, but the entity's analysis must provide sufficient appropriate audit evidence for the auditor to formulate his or her conclusion. In addition, written representations may be obtained stating that the entity has not received any advice or opinions that are contradictory to the entity's support for the tax accrual.

.22 If the auditor is unable to accumulate sufficient appropriate audit evidence about whether there is a supported and reasonable basis for the entity's position, the auditor is required to consider the effect of this scope limitation on his or her opinion.[10]

[Issue Date: March 1981; Amended: April 9, 2003; Revised: December 2005; Revised: March 2006; Revised: March 2008; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

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[9] Paragraph .11 of this interpretation.

[10] Paragraphs .11–.14 of section 705.

New GASB Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

Interpretation No. 2, "Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan" (paragraphs .23–.29), Interpretation No. 3, "Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan" (paragraphs .30–.36), and Interpretation Nos. 1–2 of section 805, *Special Considerations —Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, are intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

2. Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan

.23 *Question*—GASB Statement No. 68 requires governmental entities (employers) participating in governmental cost-sharing multiple-employer pension plans (cost-sharing plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.24 Do the audited financial statements of the plan prepared in accordance with generally accepted accounting principles (GAAP) and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.25 *Interpretation*—No. GASB Statement No. 67 requires only the disclosure of the collective net pension liability for all participating employers in GAAP financial statements of cost-sharing plans, not each employer's proportionate share of the collective net pension liability. Further, GAAP does not require the plan to present deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's share of collective pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.26 Absent additional audit evidence from the cost-sharing plan (for example, auditor's opinions on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts), the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.27 *Question*—A plan has engaged its auditor to audit and report on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. May an employer auditor use the plan auditor's report as evidence for the audit of the employer's financial statements?

.28 *Interpretation*—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedules as evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

.29 Before using the report of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer auditor has a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (that is, the numerator of the calculation), to recalculate the allocation percentage for the employer, and to recalculate the pension amounts allocated to the employer based on the allocation percentage.

[Issue Date: April 2014.]

3. Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan

.30 *Question*—GASB Statement No. 68 requires governmental entities (employers) participating in governmental agent multiple-employer pension plans (agent plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.31 Do the audited financial statements of the plan prepared in accordance with GAAP and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.32 *Interpretation*—No. GASB Statement No. 67 does not require the plan to present net pension liability, deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's specific pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.33 Absent additional evidence obtained, for example, through the suggested best practices as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting*, the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.34 *Question*—A plan has engaged its auditor to audit and report on the schedule of changes in fiduciary net position by employer, as described in the AICPA's State and Local Governments Expert Panel white paper referenced in paragraph .33 of this interpretation. May an employer auditor use the plan auditor's report as evidence about the fiduciary net position and changes in fiduciary net position for the audit of the employer's financial statements?

.35 *Interpretation*—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedule as evidence about both the fiduciary net position and changes in fiduciary net position of the employer. However, the employer auditor should consider whether the opinion is on the schedule as a whole or on each employer column. If the opinion is on the schedule as a whole, it is likely that the employer auditor will need additional evidence to support these amounts in the employer's financial statements (examples of such audit evidence are included in the white paper referenced in paragraph .33 of this interpretation).

.36 Before using the work of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedule are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes.

[Issue Date: June 2014.]

AU-C Section 501

Audit Evidence — Specific Considerations for Selected Items

Source: SAS No. 122; SAS No. 136; SAS No. 142; SAS No. 143; SAS No. 144; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 500, *Audit Evidence*; section 540, *Auditing Accounting Estimates and Related Disclosures*; and other relevant AU-C sections, regarding certain aspects of (*a*) investments in securities and derivative instruments; (*b*) inventory; (*c*) litigation, claims, and assessments involving the entity; (*d*) segment information in an audit of financial statements; and (*e*) use of management's specialists. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the

a. valuation of investments in securities and derivative instruments;

b. existence and condition of inventory;

c. completeness of litigation, claims, and assessments involving the entity;

d. presentation and disclosure of segment information, in accordance with the applicable financial reporting framework; and

e. work of management's specialists.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Definition

.04 For purposes of GAAS, the following term has the meaning attributed as follows:

Management's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Requirements

Investments in Securities and Derivative Instruments (Ref: par. .A1–.A4)

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting)

.05 When investments in securities are valued based on an investee's financial results, excluding investments accounted for using the equity method of accounting, the auditor should obtain audit evidence regarding the investee's financial results. including as applicable in the circumstances, performing the following procedures: (Ref: par. .A5–.A9)

a. Obtain and read available financial statements of the investee and the accompanying audit report, if any, including determining whether the report of the other auditor is satisfactory for this purpose.

b. If the investee's financial statements are not audited, or if the audit report on such financial statements is not satisfactory to the auditor, apply, or request that the investor entity arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor entity.

c. If the carrying amount of the investment reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's carrying amounts, obtain sufficient appropriate audit evidence regarding such amounts.

d. If the difference between the financial statement period of the entity and the investee has or could have a material effect on the entity's financial statements, determine whether the entity's management has properly considered the lack of comparability and determine the effect, if any, on the auditor's report. (Ref: par. .A10)

If the auditor is not able to obtain sufficient appropriate audit evidence in support of the investee's financial results because of an inability to perform appropriate procedures, the auditor should determine the effect on the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Paragraph renumbered by the issuance of SAS No. 142, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.06 With respect to subsequent events and transactions of the investee occurring after the date of the investee's financial statements but before the date of the auditor's report, the auditor should obtain and read available interim financial statements of the investee and make appropriate inquiries of management of the investor to identify such events and transactions that may be material to the investor's financial statements and that may need to be recognized or disclosed in the investor's financial statements. (Ref: par. .A11) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value]

[.07–.11] [Paragraphs deleted by the issuance of SAS No. 143, July 2020.][1]

Inventory

.12 If inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory[2] by

a. attending physical inventory counting, unless impracticable, to (Ref: par. .A21–.A23)

[1][Footnote deleted by the issuance of SAS No. 143, July 2020.]

i. evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting, (Ref: par. .A24)

ii. observe the performance of management's count procedures, (Ref: par. .A25)

iii. inspect the inventory, and (Ref: par. .A26)

iv. perform test counts and (Ref: par. .A27)

b. performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. (Ref: par. .A28–.A31)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.13 If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor should, in addition to the procedures required by paragraph .12, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are recorded properly. (Ref: par. .A32–.A34) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.14 If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor should make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.15 If attendance at physical inventory counting is impracticable, the auditor should perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor should modify the opinion in the auditor's report, in accordance with section 705. (Ref: par. .A35–.A37) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.16 If inventory under the custody and control of a third party is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

a. Request confirmation from the third party regarding the quantities and condition of inventory held on behalf of the entity (Ref: par. .A38)

b. Perform inspection or other audit procedures appropriate in the circumstances (Ref: par. .A39)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

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[2]Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the auditor's procedures to respond to the assessed risks of material misstatements at the relevant assertion level.

Litigation, Claims, and Assessments

.17 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, including (Ref: par. .A40–.A46)

a. inquiring of management and, when applicable, others within the entity, including in-house legal counsel;

b. obtaining from management a description and evaluation of litigation, claims, and assessments that existed at the date of the financial statements being reported on and during the period from the date of the financial statements to the date the information is furnished, including an identification of those matters referred to legal counsel;[3]

c. reviewing minutes of meetings of those charged with governance; documents obtained from management concerning litigation, claims, and assessments; and correspondence between the entity and its external legal counsel; and

d. reviewing legal expense accounts and invoices from external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.18 For actual or potential litigation, claims, and assessments identified based on the audit procedures required in paragraph .17, the auditor should obtain audit evidence relevant to the following factors:

a. The period in which the underlying cause for legal action occurred

b. The degree of probability of an unfavorable outcome

c. The amount or range of potential loss

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Communication With the Entity's Legal Counsel

.19 Unless the audit procedures required by paragraph .17 indicate that no actual or potential litigation, claims, or assessments that may give rise to a risk of material misstatement exist, the auditor should, in addition to the procedures required by other AU-C sections, seek direct communication with the entity's external legal counsel. The auditor should do so through a letter of inquiry prepared by management and sent by the auditor requesting the entity's external legal counsel to communicate directly with the auditor. (Ref: par. .A41 and .A47–.A64) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.20 In addition to the direct communications with the entity's external legal counsel referred to in paragraph .19, the auditor should, in cases when the entity's in-house legal

[3]For purposes of this section, the term *legal counsel* refers to the entity's in-house legal counsel and external legal counsel.

counsel has the responsibility for the entity's litigation, claims, and assessments, seek direct communication with the entity's in-house legal counsel through a letter of inquiry similar to the letter referred to in paragraph .19. Audit evidence obtained from in-house legal counsel in this manner is not, however, a substitute for the auditor seeking direct communication with the entity's external legal counsel, as described in paragraph .19. (Ref: par. .A65) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.21 The auditor should document the basis for any determination not to seek direct communication with the entity's legal counsel, as required by paragraphs .19–.20. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.22 The auditor should request management to authorize the entity's legal counsel to discuss applicable matters with the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.23 As described in paragraphs .19–.20, the auditor should request, through letter(s) of inquiry, the entity's legal counsel to inform the auditor of any litigation, claims, assessments, and unasserted claims that the counsel is aware of, together with an assessment of the outcome of the litigation, claims, and assessments, and an estimate of the financial implications, including costs involved. Each letter of inquiry should include, but not be limited to, the following matters: (Ref: par. .A89)

1. Identification of the entity, including subsidiaries, and the date of the audit
2. A list prepared by management (or a request by management that the legal counsel prepare a list) that describes and evaluates pending or threatened litigation, claims, and assessments with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the company in the form of legal consultation or representation
3. A list prepared by management that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the entity in the form of legal consultation or representation
4. Regarding each matter listed in item *b*, a request that the legal counsel either provide the following information or comment on those matters on which the legal counsel's views may differ from those stated by management, as appropriate:
   i. A description of the nature of the matter, the progress of the case to date, and the action that the entity intends to take (for example, to contest the matter vigorously or to seek an out-of-court settlement)
   ii. An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss (Ref: par. .A66)
   iii. With respect to a list prepared by management (or by the legal counsel at management's request), an identification of the omission of any pending or

threatened litigation, claims, and assessments or a statement that the list of such matters is complete

5. Regarding each matter listed in item *c*, a request that the legal counsel comment on those matters on which the legal counsel's views concerning the description or evaluation of the matter may differ from those stated by management
6. A statement that management understands that whenever, in the course of performing legal services for the entity with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, the legal counsel has formed a professional conclusion that the entity should disclose or consider disclosure concerning such possible claim or assessment, the legal counsel, as a matter of professional responsibility to the entity, will so advise the entity and will consult with the entity concerning the question of such disclosure and the requirements of the applicable financial reporting framework (for example, the requirements of Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 450, *Contingencies*)
7. A request that the legal counsel confirm whether the understanding described in item *f* is correct
8. A request that the legal counsel specifically identify the nature of, and reasons for, any limitation on the response
9. A request that the legal counsel specify the effective date of the response

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.24 When the auditor is aware that an entity has changed legal counsel or that the legal counsel previously engaged by the entity has resigned, the auditor should consider making inquiries of management or others about the reasons such legal counsel is no longer associated with the entity. (Ref: par. .A56) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.25 The auditor should modify the opinion in the auditor's report, in accordance with section 705, if (Ref: par. .A57–.A66)

a. the entity's legal counsel refuses to respond appropriately to the letter of inquiry and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures or
b. management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Segment Information

.26 The auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information, in accordance with the applicable financial reporting framework, by (Ref: par. .A67–.A68)

a. obtaining an understanding of the methods used by management in determining segment information and (Ref: par. .A69)
   i. evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and
   ii. when appropriate, testing the application of such methods and
b. performing analytical procedures or other audit procedures appropriate in the circumstances.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Management's Specialist

.27 If information to be used as audit evidence has been prepared using the work of a management's specialist, the auditor should, to the extent necessary, taking into account the significance of that specialist's work for the auditor's purposes, perform the following: (Ref: par. .A70–.A72)

a. Evaluate the competence, capabilities, and objectivity of that specialist (Ref: par. .A73–.A79)
b. Obtain an understanding of the work of that specialist (Ref: par. .A80–.A83)
c. Evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion (Ref: par. .A84–.A88)

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Application and Other Explanatory Material

Investments in Securities and Derivative Instruments (Ref: par. .05–.06)

.A1 Section 540 addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. This section addresses aspects relating to auditing valuation of investments in securities and derivative instruments that are incremental to section 540. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A2 Evaluating audit evidence for assertions about investments in securities and derivative instruments often involves professional judgment because the assertions, especially those about valuation, are based on highly subjective assumptions or are particularly sensitive to changes in the underlying circumstances. Valuation assertions relating to investments in securities and derivative instruments may be based on assumptions about the occurrence of future events for which expectations are difficult to develop or on assumptions about conditions expected to exist over a long period (for example, default rates or prepayment rates). Accordingly, competent persons could reach different conclusions about estimates of fair values or estimates of ranges of fair values. Professional judgment also may be necessary when evaluating audit evidence for assertions based on features of the security or derivative and the requirements of the applicable financial reporting framework, including underlying criteria for hedge accounting, which may be complex. For example, determining the fair value of a structured note may require consideration of a variety of features of the note that react differently to changes in economic conditions. In addition, one or more other derivatives may be designated to hedge changes in cash flows under the note. Evaluating audit evidence about the fair value of the note, the determination of whether the hedge is highly effective, and the allocation of changes in fair value to earnings and other comprehensive income requires professional judgment. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

[.A3] [Paragraph renumbered and deleted by issuance of SAS No. 143, July 2020]

Investments in Securities When Valuations Are Based on Cost

.A4 Procedures to obtain evidence about the valuation of securities that are recorded at cost may include inspection of documentation of the purchase price, confirmation with the issuer or holder of those securities, and testing discount or premium amortization either by recomputation or through the use of analytical procedures. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .05–.06)

.A5 Section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses auditing investments accounted for using the equity method of accounting. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A6 For valuations based on an investee's financial results (excluding investments accounted for using the equity method of accounting), obtaining and reading the financial statements of the investee that have been audited by an auditor whose report is satisfactory may be sufficient for the purpose of obtaining sufficient appropriate audit evidence of the amount used in the estimate. In determining whether the report of another auditor is satisfactory, the auditor may perform procedures such as making inquiries regarding the professional reputation and standing of the other auditor, visiting the other auditor, discussing the audit procedures followed and the results thereof, and reviewing the audit plan and audit documentation of the other auditor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A7 After obtaining and reading the audited financial statements of an investee, the auditor may conclude that additional audit procedures are necessary to obtain sufficient appropriate audit evidence, for example, when the date of the audited financial statements is different from the investor's measurement date. Further examples for when the auditor may conclude that additional audit evidence is needed include significant differences in accounting principles, changes in ownership, or the significance of the investment to the investor's financial position or results of operations. Examples of procedures that the auditor may perform are reviewing information in the investor's files that relates to the investee, such as investee minutes and budgets, and investee cash flow information and making inquiries of investor management about the investee's financial results. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A8 The auditor may need to obtain evidence relating to transactions between the entity and investee to evaluate

a. the propriety of the elimination of unrealized profits and losses on transactions between the entity and investee, if applicable, and

b. the adequacy of disclosures about material related party transactions or relationships.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A9 Section 540 addresses auditing fair value accounting estimates. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A10 The date of the investor's financial statements and those of the investee may be different. If the difference between the date of the entity's financial statements and those of the investee has or could have a material effect on the entity's financial statements, the auditor is required, in accordance with paragraph .05*d*, to determine whether the entity's management has properly considered the lack of comparability. The effect may be material, for example, because the difference between the financial statement period ends of the entity and investee is not consistent with the prior period in comparative statements or because a significant transaction occurred during the time period between the financial statement period end of the entity and investee. If a change in the difference between the financial statement period end of the entity and investee has a material effect on the investor's financial statements, the auditor may be required, in accordance with section 708, *Consistency of Financial Statements*, to add an emphasis-of-matter paragraph to the auditor's report because the comparability of financial statements between periods has been materially affected by a change in reporting period. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A11 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value (Ref: par. .07–.09)]

[.A12–.A20] [Paragraphs renumbered and deleted by the issuance of SAS No. 143, July 2020.][4-6]

Inventory

Attendance at Physical Inventory Counting (Ref: par. .12a)

.A21 Management ordinarily establishes procedures under which inventory is physically counted at least once per year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A22 Attendance at physical inventory counting involves

- inspecting the inventory to ascertain its existence and evaluate its condition and performing test counts,
- observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count, and
- obtaining audit evidence about the reliability of management's count procedures.

These procedures may serve as tests of controls or substantive procedures, or both, depending on the auditor's risk assessment, planned approach, and the specific procedures carried out. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A23 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .12–.16) include, for example, the following:

- The risks of material misstatement related to inventory.
- The control risk related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.

[4-6][Footnotes deleted by the issuance of SAS No. 143, July 2020.]

- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. Section 600A addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's specialist is needed. Section 620, *Using the Work of an Auditor's Specialist*, addresses the use of an auditor's specialist to assist the auditor in obtaining sufficient appropriate audit evidence.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluate Management's Instructions and Procedures (Ref: par. .12a(i))

.A24 Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example, the following:

- The application of appropriate controls (for example, the collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures)
- The accurate identification of the stage of completion of work in progress; slow moving, obsolete, or damaged items; and inventory owned by a third party (for example, on consignment)
- The procedures used to estimate physical quantities, when applicable, such as may be needed in estimating the physical quantity of a coal pile
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut-off date

[Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Observe the Performance of Management's Count Procedures (Ref: par. .12a(ii))

.A25 Observing the performance of management's count procedures (for example, those relating to control over the movement of inventory before, during, and after the count) assists the auditor in obtaining audit evidence that management's instructions and count procedures are designed and implemented adequately. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inspect the Inventory (Ref: par. .12a(iii))

.A26 Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying obsolete, damaged, or aging inventory. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Perform Test Counts (Ref: par. .12a(iv))

.A27 Performing test counts (for example, by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records) provides audit evidence about the completeness and accuracy of those records. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A28 In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of an External Inventory-Taking Firm

.A29 Management may engage external organizations that have expertise in the taking of physical inventories to count, list, price, and subsequently compute the total dollar amount of inventory on hand at the date of the physical count. For example, such external inventory-taking firms are often used by entities such as retail stores, hospitals, and automobile dealers. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A30 The report of an external inventory-taking firm about the work it performed does not, by itself, provide the auditor with sufficient appropriate audit evidence. Paragraph .12 requires the auditor, if inventory is material to the financial statements, to perform certain procedures regarding the existence and condition of inventory.[7] The auditor may, for example, examine the external inventory-taking firm's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis, and apply appropriate tests to the intervening transactions. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A31 Although the auditor may adjust the extent of the work on the physical count of inventory because of the work of an external inventory-taking firm, any restriction imposed on the auditor such that the auditor is unable to perform the procedures that the auditor considers necessary is a scope limitation. In such cases, section 705 requires the auditor to

[7] [Footnote deleted by the issuance of SAS No. 144, June 2021.]

modify the opinion in the auditor's report as a result of the scope limitation. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Physical Inventory Counting Conducted Other Than at the Date of the Financial Statements (Ref: par. .13)

.A32 For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation, and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date (or dates) other than the date of the financial statements is appropriate for audit purposes. Section 330 addresses substantive procedures performed at an interim date.[8] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A33 When a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A34 Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are recorded properly include the following:

- Whether the perpetual inventory records are properly adjusted
- Reliability of the entity's perpetual inventory records
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Attendance at Physical Inventory Counting Is Impracticable (Ref: par. .15)

.A35 In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory (for example, when inventory is held in a location that may pose threats to the safety of the auditor). The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the matter of difficulty, time, or cost involved is not, in itself, a valid basis for the auditor to omit an audit procedure for which no alternative

[8] Paragraphs .23–.24 of section 330.

exists or to be satisfied with audit evidence that is less than persuasive. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A36 In some cases, when attendance is impracticable, alternative audit procedures (for example, observing a current physical inventory count and reconciling it to the opening inventory quantities or inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting) may provide sufficient appropriate audit evidence about the existence and condition of inventory. If the audit covers the current period and one or more periods for which the auditor had not observed or made some physical counts of prior inventories, alternative audit procedures, such as tests of prior transactions or reviews of the records of prior counts, may provide sufficient appropriate audit evidence about the prior inventories. The effectiveness of the alternative procedures that an auditor may perform is affected by the length of the period that the alternative procedures cover. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A37 In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, section 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. In addition, section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's procedures regarding inventory opening balances in initial audit engagements.[9] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inventory Under the Custody and Control of a Third Party

Confirmation (Ref: par. .16a)

.A38 Section 505, *External Confirmations*, addresses external confirmation procedures. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Other Audit Procedures (Ref: par. .16b)

.A39 Depending on the circumstances (for example, when information is obtained that raises doubt about the integrity and objectivity of the third party), the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include the following:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable
- Obtaining another auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded
- Inspecting documentation regarding inventory held by third parties (for example, warehouse receipts)

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[9]Paragraph .A13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

- Requesting confirmation from other parties when inventory has been pledged as collateral

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Litigation, Claims, and Assessments

Completeness of Litigation, Claims, and Assessments (Ref: par. .17)

.A40 Litigation, claims, and assessments involving the entity may have a material effect on the financial statements and, thus, may be required to be recognized, measured, or disclosed in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A41 Other legal matters involving the entity may not have a material effect on the entity's financial statements and, accordingly, would not give rise to risks of material misstatement. Examples of such other legal matters may be

- matters unrelated to actual or potential litigation, claims, or assessments, such as consulting services related to real estate or potential merger and acquisition transactions;
- matters in which the entity records indicate that management or the legal counsel has not devoted substantive attention to the matter;
- matters in which the entity's insurance coverage exceeds the amount of the actual or potential litigation, claim, or assessment sought against the entity; or
- matters that are clearly trivial to the financial statements.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A42 Management is responsible for adopting policies and procedures to identify, evaluate, and account for litigation, claims, and assessments as a basis for the preparation of financial statements, in accordance with the requirements of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A43 Management is the primary source of information about events or conditions considered in the financial accounting for, and reporting of, litigation, claims, and assessments because these matters are within the direct knowledge and, often, control of management. Accordingly, the auditor's procedures with respect to litigation, claims, and assessments include the following:

- Making inquiries of management as required by paragraph .17*a*, which may include a discussion about the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement
- Obtaining written representations from management, in accordance with section 580, *Written Representations*, that all known actual or possible litigation, claims,

and assessments whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework[10]

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A44 In addition to the procedures identified in paragraph .17, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation, claims, and assessments involving the entity. Examples of such procedures are as follows:

- Reading minutes of meetings of stockholders; directors; governing bodies of governmental entities; and appropriate committees held during, and subsequent to, the period being audited
- Reading contracts, loan agreements, leases, correspondence from taxing or other governmental agencies, and similar documents
- Obtaining information concerning guarantees from bank confirmation forms
- Inspecting other documents for possible guarantees by the entity

Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity and its environment.[11] In addition, section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, requires the auditor to obtain an understanding of the entity's legal and regulatory framework applicable to the entity and industry or sector in which the entity operates and how the entity is complying with that framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A45 Audit evidence obtained for purposes of identifying litigation, claims, and assessments that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation, claims, and assessments. Section 540 establishes requirements and provides guidance relevant to the auditor's consideration of litigation, claims, and assessments requiring accounting estimates or related disclosures in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A46 This section addresses inquiries of the entity's legal counsel with whom management has consulted. If management has not consulted legal counsel, the auditor would rely on the procedures required by paragraph .17 to identify litigation, claims, and assessments involving the entity, which may give rise to a risk of material misstatement, and the written representation of management regarding litigation, claims, and assessments, as required by section 580. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

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[10]Paragraph .15 of section 580, *Written Representations*.

[11]Paragraph .12 of section , *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Communication With the Entity's Legal Counsel (Ref: par. .19–.25)

.A47 An auditor ordinarily does not possess legal skills and, therefore, cannot make legal judgments concerning information coming to the auditor's attention. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A48 Direct communication with the entity's legal counsel assists the auditor in obtaining sufficient appropriate audit evidence about whether potentially material litigation, claims, and assessments are known and management's estimates of the financial implications, including costs, are reasonable. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A49 The American Bar Association (ABA) has approved *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (the ABA statement), which explains the concerns of the legal counsel and the nature of the limitations that an auditor is likely to encounter in connection with seeking direct communication with the entity's legal counsel about litigation, claims, assessments, and unasserted claims.[12] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A50 A letter of inquiry to the entity's legal counsel is the auditor's primary means of obtaining corroboration of the information provided by management concerning material litigation, claims, and assessments. Audit evidence obtained from the entity's in-house general counsel or legal department may provide the auditor with the necessary corroboration. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A51 In certain circumstances, the auditor also may judge it necessary to meet with the entity's legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, when

- the auditor determines that the matter is a significant risk.
- the matter is complex.
- a disagreement exists between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A52 An external legal counsel's response to a letter of inquiry and the procedures set forth in paragraphs .17–.18 provide the auditor with sufficient appropriate audit evidence concerning the accounting for, and reporting of, pending and threatened litigation, claims, and assessments. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A53 Audit evidence about the status of litigation, claims, and assessments up to the date of the auditor's report may be obtained by inquiry of management, including in-house

[12] The *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* is reprinted as exhibit A, "American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," for the convenience of readers but is not an integral part of this section.

legal counsel responsible for dealing with the relevant matters. The auditor may need to obtain updated information from the entity's legal counsel. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A54 In accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report 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.[13] Accordingly, it is preferable that the entity's legal counsel's response be as close to the date of the auditor's report as is practicable in the circumstances. Specifying the effective date of the entity's legal counsel's response to reasonably approximate the expected date of the auditor's report may obviate the need to obtain updated information from the entity's legal counsel. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A55 Clearly specifying the earliest acceptable effective date of the response and the latest date by which it is to be sent to the auditor and informing the entity's legal counsel of these dates timely facilitates the entity's legal counsel's ability to respond timely and adequately. A two-week period between the specified effective date of the entity's legal counsel's response and the latest date by which the response is to be sent to the auditor is generally sufficient. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A56 In some circumstances, the legal counsel may be required by relevant ethical requirements to resign the engagement if the legal counsel's advice concerning financial accounting and reporting for litigation, claims, and assessments is disregarded by the entity. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A57 The legal counsel appropriately may limit the response to matters to which the legal counsel has given substantive attention in the form of legal consultation or representation. Also, the legal counsel's response may be limited to matters that are considered individually or collectively material to the financial statements, such as when the entity and auditor have reached an understanding on the limits of materiality for this purpose and management has communicated such understanding to the legal counsel. Such limitations are not limitations on the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A58 The legal counsel may be unable to respond concerning the likelihood of an unfavorable outcome of litigation, claims, and assessments or the amount or range of potential loss because of inherent uncertainties. Factors influencing the likelihood of an unfavorable outcome sometimes may not be within the legal counsel's competence to judge; historical experience of the entity in similar litigation or the experience of other entities may not

[13]Paragraph .43 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .82 and .126 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

be relevant or available, and the amount of the possible loss frequently may vary widely at different stages of litigation. Consequently, the legal counsel may not be able to form a conclusion with respect to such matters. In such circumstances, the auditor may conclude that the financial statements are affected by an uncertainty concerning the outcome of a future event that cannot be reasonably estimated. If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, section 705 requires the auditor to modify the opinion in addressing the effect, if any, of the legal counsel's response on the auditor's report as a result of the scope limitation.[14] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A59 An external legal counsel's refusal to furnish the information requested in an inquiry letter either in writing or orally may cause a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A60 Although the auditor would consider the inability to review information that could have a significant bearing on the audit as a scope limitation, in recognition of the public interest in protecting the confidentiality of lawyer-client communications, such inability is not intended to require an auditor to examine documents that the client identifies as subject to the lawyer-client privilege. In the event of questions concerning the applicability of this privilege, the auditor may request confirmation from the entity's legal counsel that the information is subject to that privilege and that the information was considered by the legal counsel in responding to the letter of inquiry or, if the matters are being handled by another legal counsel, an identification of such legal counsel for the purpose of sending a letter of inquiry. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A61 If management imposes a limitation on the scope of the audit and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor is required by section 705 to either disclaim an opinion on the financial statements or, when practicable, withdraw from the audit.[15] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A62 In some cases, in order to emphasize the preservation of the attorney-client privilege or the attorney work-product privilege, some entities may include the following or substantially similar language in the audit inquiry letter to legal counsel:

> We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

For the same reason, some legal counsel may include the following or substantially similar language in their response letters to auditors:

[14] Paragraph .07 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[15] Paragraph .13 of section 705.

> The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

Explanatory language similar to the foregoing in the letters of the entity or legal counsel is not a limitation on the scope of the legal counsel's response. See exhibit B, "Report of the Subcommittee on Audit Inquiry Responses." [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A63 In order to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments, some legal counsel may include the following or substantially similar language in their responses to audit inquiry letters:

> Please be advised that pursuant to clauses (b) and (c) of Paragraph 5 of the ABA Statement of Policy [*American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*] and related Commentary referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the Company. We can only furnish information concerning those unasserted possible claims or assessments upon which the Company has specifically requested in writing that we comment. We also cannot comment upon the adequacy of the Company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same.

Additional language similar to the foregoing in a letter from legal counsel is not a limitation on the scope of the audit. However, the ABA statement and the understanding between the legal and accounting professions assumes that the legal counsel, under certain circumstances, will advise and consult with the entity concerning the entity's obligation to make financial statement disclosure with respect to unasserted possible claims or assessments. Confirmation of this understanding is included in the legal counsel's response. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A64 If the auditor believes that there may be actual or potential material litigation, claims, or assessments and the entity has not engaged external legal counsel relating to such matters, the auditor may discuss with the client the possible need to consult legal counsel to assist the client in determining the appropriate measurement, recognition, or disclosure of related liabilities or loss contingencies in the financial statements, in accordance with the applicable financial reporting framework. Depending on the significance of the matter(s), refusal by management to consult legal counsel in these circumstances may result in a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Direct Communication With the Entity's In-House Legal Counsel

.A65 In-house legal counsel can range from one lawyer to a large staff, with responsibilities ranging from specific internal matters to a comprehensive coverage of all of the entity's legal needs, including litigation with outside parties. Because both in-house and external legal counsel are bound by an applicable code of ethics, there should be no significant difference in their professional obligations and responsibilities. In some circumstances, external legal counsel, if used at all, may be used only for limited purposes, such as data accumulation or account collection activity. In such circumstances, in-house legal counsel may have the primary responsibility for corporate legal matters and may be in the best position to know and precisely describe the status of all litigation, claims, and assessments or to corroborate information provided by management. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluation of the Outcome of Litigation, Claims, or Assessment (Ref: par. .23d(ii))

.A66 Although paragraph 5 of the ABA statement states that the legal counsel "may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is 'probable' or 'remote,'" the legal counsel is not required to use those terms in communicating the evaluation to the auditor. The auditor may find other wording sufficiently clear, as long as the terms can be used to classify the outcome of the uncertainty under one of the three probability classifications established in FASB ASC 450. Some examples of evaluations concerning litigation that may be considered to provide sufficient clarity that the likelihood of an unfavorable outcome is remote, even though they do not use that term, are the following:

- "We are of the opinion that this action will not result in any liability to the company."
- "It is our opinion that the possible liability to the company in this proceeding is nominal in amount."
- "We believe the company will be able to defend this action successfully."
- "We believe that the plaintiff's case against the company is without merit."
- "Based on the facts known to us, after a full investigation, it is our opinion that no liability will be established against the company in these suits."

Absent any contradictory information obtained by the auditor either in other parts of the legal counsel's letter or otherwise, the auditor need not obtain further clarification of evaluations such as the foregoing. Because of inherent uncertainties described in paragraph .A58 and the ABA statement, an evaluation furnished by the legal counsel may indicate significant uncertainties or stipulations about whether the client will prevail. The following are examples of the legal counsel's evaluations that are unclear about the likelihood of an unfavorable outcome:

- "This action involves unique characteristics wherein authoritative legal precedents do not seem to exist. We believe that the plaintiff will have serious problems establishing the company's liability under the act; nevertheless, if the plaintiff is successful, the award may be substantial."

- "It is our opinion that the company will be able to assert meritorious defenses to this action." (The term *meritorious defenses* indicates that the entity's defenses will not be summarily dismissed by the court; it does not necessarily indicate the legal counsel's opinion that the entity will prevail.)
- "We believe the action can be settled for less than the damages claimed."
- "We are unable to express an opinion as to the merits of the litigation at this time. The company believes there is absolutely no merit to the litigation." (If the entity's legal counsel, with the benefit of all relevant information, is unable to conclude that the likelihood of an unfavorable outcome is remote, it is unlikely that management would be able to form a judgment to that effect.)
- "In our opinion, the company has a substantial chance of prevailing in this action." (A *substantial chance*, a *reasonable opportunity*, and similar terms indicate more uncertainty than an opinion that the company will prevail.)

If the auditor is uncertain about the meaning of the legal counsel's evaluation, clarification either in a follow-up letter or conference with the legal counsel and entity, appropriately documented, may be appropriate. If the legal counsel is still unable to give an unequivocal evaluation of the likelihood of an unfavorable outcome in writing or orally, the auditor is required by section 700, or section 703, to determine the effect, if any, of the legal counsel's response on the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Segment Information (Ref: par. .26)

.A67 Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Considerations Specific to Governmental Entities

.A68 For governmental entities required by the applicable financial reporting framework to disclose segment information, the auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements of the opinion unit(s) on which the segment information is based.[16] [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

[16]Paragraph .A14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Understanding of the Methods Used by Management (Ref: par. .26a)

.A69 Depending on the circumstances, examples of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include the following:

- Sales, transfers, and charges between segments and elimination of intersegment amounts
- Comparisons with budgets and other expected results (for example, operating profits as a percentage of sales)
- The allocation of assets and costs among segments
- Consistency with prior periods and the adequacy of the disclosures with respect to inconsistencies
- Management's process for identifying those segments that require disclosure in accordance with the entity's financial reporting framework

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of a Management's Specialist (Ref: par. .27)

.A70 The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement and may be a significant deficiency or material weakness.[17] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A71 When information to be used as audit evidence has been prepared using the work of a management's specialist, the requirement in paragraph .27 applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which no observable market exists. If the individual or organization applies that expertise in making an estimate, which the entity uses in preparing its financial statements, the individual or organization is a management's specialist, and paragraph .27 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity, which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to the evaluation required by section 500,[18] but it is not the use of a management's specialist by the entity. [Paragraph added, effective for audits of financial

[17] See section 265, *Communicating Internal Control Related Matters Identified in an Audit*, for further guidance. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A72 The nature, timing, and extent of audit procedures with regard to the requirement in paragraph .27 may be affected by matters such as the following:

- The nature and complexity of the matter to which the management's specialist relates
- The risks of material misstatement of the matter
- The availability of alternative sources of audit evidence
- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the management's specialist (including, when applicable, the organization that employs the individual specialist), thereby influencing the work of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements
- The nature and extent of any controls within the entity over the work of the management's specialist
- The auditor's knowledge and experience of the field of expertise of management's specialist
- The auditor's previous experience of the work of that specialist

More persuasive audit evidence is needed with regard to the requirement in paragraph .27 as the significance of the management's specialist's work, the risk of material misstatement at the relevant assertion level, or the ability of management to affect the specialist's judgments increases, or as the competence, capabilities, and objectivity possessed by the specialist in the particular field decreases. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

The Competence, Capabilities, and Objectivity of a Management's Specialist (Ref: par. .27a)

.A73 Competence relates to the nature and level of expertise of the management's specialist. Capability relates to the ability of the management's specialist to exercise that competence

[18]See paragraph .07 of section 500, *Audit Evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

in the circumstances. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the management's specialist. The competence, capabilities, and objectivity of a management's specialist, and any controls within the entity over that specialist's work, are important factors with regard to the reliability of any information produced by a management's specialist. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A74 Information regarding the competence, capabilities, and objectivity of a management's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- An auditor's specialist, if any, that assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's specialist

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A75 Matters relevant to evaluating the competence, capabilities, and objectivity of a management's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A76 Other matters that may be relevant include the following:

- The relevance of the capabilities and competence of the management's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations

- The competence of the management's specialist with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the management's specialist as the audit progresses

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A77 A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist's environment (for example, quality control policies and procedures). [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A78 Although safeguards cannot eliminate all threats to the objectivity of a management's specialist, threats such as intimidation threats may be of less significance to a specialist engaged by the entity than to a specialist employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, a specialist employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A79 When evaluating the objectivity of a specialist engaged by the entity, it may be relevant to discuss with management and that specialist any interests and relationships that may create threats to the specialist's objectivity and any applicable safeguards, including any professional requirements that apply to the specialist, and to evaluate whether the safeguards are adequate. Relevant information may be obtained by the auditor from procedures performed in accordance with section 550, *Related Parties*. Interests and relationships creating threats may include the following:

- Financial interests
- Business and personal relationships between the entity and the individual specialist and between the entity and the organization that employs the individual specialist
- Provision of other services

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

*Obtaining an Understanding of the Work of the Management's Specialist (Ref: **par. .27b**)*

.A80 An understanding of the work of the management's specialist includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's specialist or whether the auditor needs an auditor's specialist for this purpose.[19] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A81 Aspects of the field of the management's specialist relevant to the auditor's understanding may include

- whether that specialist's field has areas of specialty within it that are relevant to the audit.
- whether any professional or other standards and regulatory or legal requirements apply.
- what assumptions and methods are used by the management's specialist and whether they are generally accepted within that specialist's field appropriately applied under the applicable financial reporting framework.
- the nature of internal and external data or information the management's specialist uses.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A82 In the case of a management's specialist engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that specialist. Evaluating that agreement when obtaining an understanding of the work of the management's specialist may assist the auditor in determining for the auditor's purposes the appropriateness of

- the nature, scope, and objectives of that specialist's work;
- the respective roles and responsibilities of management and that specialist; and
- the nature, timing, and extent of communication between management and that specialist, including the form of any report to be provided by that specialist.

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[19]Paragraph .07 of section 620, *Using the Work of an Auditor's Specialist*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Footnote renumbered by the issuance of SAS No. 144, June 2021.]

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A83 In the case of a management's specialist employed by the entity, it is less likely that there will be a written agreement of this kind. Inquiry of the specialist and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

*Evaluating the Appropriateness of the Work of the Management's Specialist (Ref: **par. .27c**)*

.A84 Section 540 includes requirements and guidance related to accounting estimates, including the selection and application of the methods, significant assumptions, and data used in making the accounting estimate.[20] Considerations when evaluating the appropriateness of the work of the management's specialist as audit evidence for the relevant assertion may include

- if that specialist's work involves significant assumptions, the appropriateness of the assumptions, taking into account the consistency of those assumptions with relevant information
- if that specialist's work involves the use of methods, the appropriateness of the methods under the circumstances, taking into account the requirements of the applicable financial reporting framework;
- if that specialist's work involves significant use of source data, including entity-produced data, the relevance and reliability of that source data; and
- the relevance and reasonableness of that specialist's findings or conclusions, the consistency of the findings or conclusions with other audit evidence, and whether the findings or conclusions have been appropriately reflected in the financial statements.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A85 If the work of the management's specialist involves use of significant assumptions developed by the management's specialist, evaluating the appropriateness of those assumptions may include taking into account the consistency of those assumptions with relevant information such as the following:

- Assumptions generally accepted within the specialist's field

[20]Paragraph .21 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

- Supporting information provided by the specialist
- Industry, regulatory, and other external factors, including economic conditions
- The entity's objectives, strategies, and related business risks
- Existing market information
- Historical or recent experience, along with changes in conditions and events affecting the entity
- Significant assumptions used in other estimates tested in the entity's financial statements

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A86 If the methods of the management's specialist include the use of a proprietary model, the auditor's procedures may include, for example

- obtaining an understanding of the model through
  - — inquiry of the specialist, and
  - — reading descriptions of the model in the specialist's report or equivalent communication;
- testing controls over the entity's evaluation of the specialist's work;
- testing mathematical accuracy of the calculations under the model, if practicable; or
- assessing the inputs to and output from the model, which may involve using an alternative model for comparison.

The extent of such procedures will depend on the type of model used (for example, commercially available versus internally developed) and the applicability of the factors described in paragraph .A72. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A87 Factors that affect the relevance and reliability of the work of the management's specialist include the following:

- The results of the auditor's procedures over internal or external data, significant assumptions, and methods
- The nature of any restrictions, disclaimers, or limitations in the specialist's report or equivalent communication
- The consistency of the management's specialist's work with other evidence obtained by the auditor and the auditor's understanding of the entity and its environment

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A88 Additional procedures may be necessary if the management's specialist's findings or conclusions appear to contradict the relevant assertion, or the management's specialist's work does not provide sufficient appropriate audit evidence. Examples of situations in which additional procedures may be necessary include the following:

- The findings and conclusions of the management's specialist are inconsistent with
  - — other information, if any, in the specialist's report, or equivalent communication,
  - — other evidence obtained by the auditor, or
  - — the auditor's understanding of the entity and its environment.
- The management's specialist's report, or equivalent communication, contains restrictions, disclaimers, or limitations regarding the auditor's use of the report or communication.
- The auditor has identified exceptions in performing procedures related to data, significant assumptions, or methods.
- The auditor has doubts about the competence, capabilities, or objectivity of the management's specialist.
- The management's specialist has a conflict of interest relevant to the specialist's work.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Appendix — Illustrative Audit Inquiry Letter to Legal Counsel (Ref: par. .23)

.A89

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

[*Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:*]

In connection with an audit of our financial statements as of (balance-sheet date) and for the (period) then ended, please furnish our auditors, (name and address of auditors), with the information requested below concerning certain contingencies involving matters with respect to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. [*When a materiality limit has been established based on an understanding between management and the auditor, the following sentence should be added: This request is limited to contingencies amounting to (amount) individually or items involving lesser amounts that exceed (amount) in the aggregate.*]

Pending or Threatened Litigation (Excluding Unasserted Claims)

[*Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.*] This letter will serve as our consent for you to furnish to our auditor all the information requested herein. Accordingly, please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated and an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

[*Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:*]

Regarding pending or threatened litigation, claims, and assessments, please include in your response: (1) the nature of each matter, (2) the progress of each matter to date, (3) how the Company is responding or intends to respond (for example, to contest the case vigorously or seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

Unasserted Claims and Assessments (Considered by Management to be Probable of Assertion and That, if Asserted, Would Have at Least a Reasonable Possibility of an Unfavorable Outcome)

[*Ordinarily management's information would include the following: (1) the nature of the matter, (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.*] Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*. Please specifically confirm to our auditors that our understanding is correct.

[*Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:*]

We have represented to our auditors that there are no unasserted possible claims or assessments that you have advised us are probable of assertion and must be disclosed in accordance with FASB ASC 450. We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of FASB ASC 450. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[*The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the Company, such as guarantees of indebtedness of others.*]

[*Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:*]

> Your response should include matters that existed as of (balance-sheet date) and during the period from that date to the effective date of your response. Please specifically identify the nature of and reasons for any limitations on your response. Our auditors expect to have the audit completed about (expected completion date). They would appreciate receiving your reply by that date with a specified effective date no earlier than (ordinarily two weeks before expected completion date).

[*Wording that could be used in an audit inquiry letter, instead of the heading and first paragraph, when the client believes that there are no unasserted claims or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board* Accounting Standards Codification *450,* Contingencies*, is as follows:*]

> *Unasserted claims and assessments* — We have represented to our auditors that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. (The second paragraph in the section relating to unasserted claims and assessments would not be altered.)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit A — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (Ref: par. .A49)

.A90

> **Note**
> This document, in the form herein set forth, was approved by the Board of Governors of the American Bar Association (ABA) in December 1975, which official action permitted its release to lawyers and accountants as the standard recommended by the ABA for the lawyer's response to letters of audit inquiry.

Source: Statement on Auditing Standards No. 12 section 337C, *Exhibit II—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*[a]

Preamble

The public interest in protecting the confidentiality of lawyer-client communications is fundamental. The American legal, political and economic systems depend heavily upon voluntary compliance with the law and upon ready access to a respected body of professionals able to interpret and advise on the law. The expanding complexity of our laws and governmental regulations increases the need for prompt, specific and unhampered lawyer-client communication. The benefits of such communication and early consultation underlie the strict statutory and ethical obligations of the lawyer to preserve the confidences and secrets of the client, as well as the long-recognized testimonial privilege for lawyer-client communication.

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors

[a]Statement on Auditing Standards No. 12 section 337C, *Exhibit II — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, has been superseded by this section.

concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with counsel's advice.

Consistent with the foregoing public policy considerations, it is believed appropriate to distinguish between, on the one hand, litigation which is pending or which a third party has manifested to the client a present intention to commence and, on the other hand, other contingencies of a legal nature or having legal aspects. As regards the former category, unquestionably the lawyer representing the client in a litigation matter may be the best source for a description of the claim or claims asserted, the client's position (e.g., denial, contest, etc.), and the client's possible exposure in the litigation (to the extent the lawyer is in a position to do so). As to the latter category, it is submitted that, for the reasons set forth above, it is not in the public interest for the lawyer to be required to respond to general inquiries from auditors concerning possible claims.

It is recognized that the disclosure requirements for enterprises subject to the reporting requirements of the Federal securities laws are a major concern of managements and counsel, as well as auditors. It is submitted that compliance therewith is best assured when clients are afforded maximum encouragement, by protecting lawyer-client confidentiality, freely to consult counsel. Likewise, lawyers must be keenly conscious of the importance of their clients being competently advised in these matters.

Statement of Policy

NOW, THEREFORE, BE IT RESOLVED that it is desirable and in the public interest that this Association adopt the following Statement of Policy regarding the appropriate scope of the lawyer's response to the auditor's request, made by the client at the request of the auditor, for information concerning matters referred to the lawyer during the course of his representation of the client:

1. *Client Consent to Response*. The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5,[b] promulgated by the Financial Accounting Standards Board in March 1975 and discussed in

Paragraph 5.1 of the accompanying Commentary), to the extent hereinafter set forth, subject to the following:

a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.

b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.

d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

2. *Limitation on Scope of Response*. It is appropriate for the lawyer to set forth in his response, by way of limitation, the scope of his engagement by the client. It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention. *Unless the lawyer's response indicates otherwise, (a) it is properly limited to matters which have been given substantive attention by the lawyer in the form of legal consultation and, where appropriate, legal representation since the beginning of the period or periods being reported upon, and (b) if a law firm or a law department, the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning those loss contingencies referred to in Paragraph 5(a) below but, beyond that, no review has been made of any of the client's transactions or other matters for the purpose of identifying loss contingencies to be described in the response*.[c]

3. *Response may be Limited to Material Items*. In response to an auditor's request for disclosure of loss contingencies of a client, it is appropriate for the lawyer's response

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[b]In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

[c]As contemplated by Paragraph 8 of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

to indicate that the response is limited to items which are considered individually or collectively material to the presentation of the client's financial statements.

4. *Limited Responses*. Where the lawyer is limiting his response in accordance with the Statement of Policy, his response should so indicate (see Paragraph 8). If in any other respect the lawyer is not undertaking to respond to or comment on particular aspects of the inquiry when responding to the auditor, he should consider advising the auditor that his response is limited, in order to avoid any inference that the lawyer has responded to all aspects; otherwise, he may be assuming a responsibility which he does not intend.

5. *Loss Contingencies*. When properly requested by the client, it is appropriate for the lawyer to furnish to the auditor information concerning the following matters if the lawyer has been engaged by the client to represent or advise the client professionally with respect thereto and he has devoted substantive attention to them in the form of legal representation or consultation:

   a. *overtly threatened or pending litigation*, whether or not specified by the client;

   b. *a contractually assumed obligation* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor;

   c. *an unasserted possible claim or assessment* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor.

   With respect to clause (a), overtly threatened litigation means that a potential claimant has manifested to the client an awareness of and present intention to assert a possible claim or assessment unless the likelihood of litigation (or of settlement when litigation would normally be avoided) is considered remote. With respect to clause (c), where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, consistent with the considerations and concerns outlined in the Preamble and Paragraph 1 hereof, the client should request the lawyer to furnish information to the auditor only if the client has determined that it is probable that a possible claim will be asserted, that there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and that the resulting liability would be material to the financial condition of the client. Examples of such situations might (depending in each case upon the particular circumstances) include the following: (i) a catastrophe, accident or other similar physical occurrence in which the client's involvement is open and notorious, or (ii) an investigation by a government agency where enforcement proceedings have been instituted or where the likelihood that they will not be instituted is remote, under circumstances where assertion of one or more private claims for redress would normally be expected, or (iii) a public disclosure by the client acknowledging (and thus focusing attention upon) the existence of one or more probable claims arising out of an event or circumstance. In assessing whether or not the assertion of a possible claim is probable, it is expected that the client would normally employ, by reason of the inherent uncertainties involved and insufficiency of available data, concepts parallel to those used by the lawyer (discussed below) in assessing whether or not an unfavorable outcome is probable; thus, assertion of a possible claim would be considered probable only when the prospects of its being asserted seem reasonably certain (i.e., supported by extrinsic evidence strong enough to establish a presumption that it will happen) and the prospects of nonassertion seem slight.

It would not be appropriate, however, for the lawyer to be requested to furnish information in response to an inquiry letter or supplement thereto if it appears that (a) the client has been required to specify unasserted possible claims without regard to the standard suggested in the preceding paragraph, or (b) the client has been required to specify all or substantially all unasserted possible claims as to which legal advice may have been obtained, since, in either case, such a request would be in substance a general inquiry and would be inconsistent with the intent of this Statement of Policy.

The information that lawyers may properly give to the auditor concerning the foregoing matters would include (to the extent appropriate) an identification of the proceedings or matter, the stage of proceedings, the claim(s) asserted, and the position taken by the client.

In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote"; for purposes of any such judgment it is appropriate to use the following meanings:

i. *probable* — an unfavorable outcome for the client is probable if the prospects of the claimant not succeeding are judged to be extremely doubtful and the prospects for success by the client in its defense are judged to be slight.

ii. *remote* — an unfavorable outcome is remote if the prospects for the client not succeeding in its defense are judged to be extremely doubtful and the prospects of success by the claimant are judged to be slight.

If, in the opinion of the lawyer, considerations within the province of his professional judgment bear on a particular loss contingency to the degree necessary to make an informed judgment, he may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is "probable" or "remote," applying the above meanings. No inference should be drawn, from the absence of such a judgment, that the client will not prevail.

The lawyer also may be asked to estimate, in dollar terms, the potential amount of loss or range of loss in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight.

The considerations bearing upon the difficulty in estimating loss (or range of loss) where pending litigation is concerned are obviously even more compelling in the case of unasserted possible claims. In most cases, the lawyer will not be able to provide any such estimate to the auditor.

As indicated in Paragraph 4 hereof, the auditor may assume that all loss contingencies specified by the client in the manner specified in clauses (b) and (c) above have received comment in the response, unless otherwise therein indicated. The lawyer should not be asked, nor need the lawyer undertake, to furnish information to the auditor concerning loss contingencies except as contemplated by this Paragraph 5.

6. *Lawyer's Professional Responsibility*. Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for or advisability of public disclosure of a wide range of events and circumstances. The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. In appropriate circumstances, the lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client. The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements[d] of FAS 5.

7. *Limitation on Use of Response. Unless otherwise stated in the lawyer's response, it shall be solely for the auditor's information in connection with his audit of the financial condition of the client and is not to be quoted in whole or in part or otherwise referred to in any financial statements of the client or related documents, nor is it to be filed with any governmental agency or other person, without the lawyer's prior written consent.*[c] *Notwithstanding such limitation, the response can properly be furnished to others in compliance with court process or when necessary in order to defend the auditor against a challenge of the audit by the client or a regulatory agency, provided that the lawyer is given written notice of the circumstances at least twenty days before the response is so to be furnished to others, or as long in advance as possible if the situation does not permit such period of notice.*[c]

8. *General*. This Statement of Policy, together with the accompanying Commentary (which is an integral part hereof), has been developed for the general guidance of the legal profession. In a particular case, the lawyer may elect to supplement or modify the approach hereby set forth. If desired, this Statement of Policy may

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[d]Under FAS 5, when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, disclosure of an unasserted possible claim is required only if the enterprise concludes that (i) it is probable that a claim will be asserted, (ii) there is a reasonable possibility, if the claim is in fact asserted, that the outcome will be unfavorable, and (iii) the liability resulting from such unfavorable outcome would be material to its financial condition.

> be incorporated by reference in the lawyer's response by the following statement: "This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any 'loss contingencies' is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement)."

The accompanying Commentary is an integral part of this Statement of Policy.

Commentary

Paragraph 1 (Client Consent to Response)

In responding to any aspect of an auditor's inquiry letter, the lawyer must be guided by his ethical obligations as set forth in the Code of Professional Responsibility. Under Canon 4 of the Code of Professional Responsibility a lawyer is enjoined to preserve the client's confidences (defined as information protected by the attorney-client privilege under applicable law) and the client's secrets (defined as other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client). The observance of this ethical obligation, in the context of public policy, "... not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance." (Ethical Consideration 4-1).

The lawyer's ethical obligation therefore includes a much broader range of information than that protected by the attorney-client privilege. As stated in Ethical Consideration 4-4: "The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge."

In recognition of this ethical obligation, the lawyer should be careful to disclose fully to his client any confidence, secret or evaluation that is to be revealed to another, including the client's auditor, and to satisfy himself that the officer or agent of a corporate client consenting to the disclosure understands the legal consequences thereof and has authority to provide the required consent.

The law in the area of attorney-client privilege and the impact of statements made in letters to auditors upon that privilege has not yet been developed. Based upon cases treating the attorney-client privilege in other contexts, however, certain generalizations can be made with respect to the possible impact of statements in letters to auditors.

It is now generally accepted that a corporation may claim the attorney-client privilege. Whether the privilege extends beyond the control group of the corporation (a concept found in the existing decisional authority), and if so, how far, is yet unresolved.

If a client discloses to a third party a part of any privileged communication he has made to his attorney, there may have been a waiver as to the whole communication; further, it has been suggested that giving accountants access to privileged statements made to attorneys may waive any privilege as to those statements. Any disclosure of privileged communications relating to a particular subject matter may have the effect of waiving the privilege on other communications with respect to the same subject matter.

To the extent that the lawyer's knowledge of unasserted possible claims is obtained by means of confidential communications from the client, any disclosure thereof might constitute a waiver as fully as if the communication related to pending claims.

A further difficulty arises with respect to requests for evaluation of either pending or unasserted possible claims. It might be argued that any evaluation of a claim, to the extent based upon a confidential communication with the client, waives any privilege with respect to that claim.

Another danger inherent in a lawyer's placing a value on a claim, or estimating the likely result, is that such a statement might be treated as an admission or might be otherwise prejudicial to the client.

The Statement of Policy has been prepared in the expectation that judicial development of the law in the foregoing areas will be such that useful communication between lawyers and auditors in the manner envisaged in the Statement will not prove prejudicial to clients engaged in or threatened with adversary proceedings. If developments occur contrary to this expectation, appropriate review and revision of the Statement of Policy may be necessary.

Paragraph 2 (Limitation on Scope of Response)

In furnishing information to an auditor, the lawyer can properly limit himself to loss contingencies which he is handling on a substantive basis for the client in the form of legal consultation (advice and other attention to matters not in litigation by the lawyer in his professional capacity) or legal representation (counsel of record or other direct professional responsibility for a matter in litigation). Some auditors' inquiries go further and ask for information on matters of which the lawyer "has knowledge." Lawyers are concerned that such a broad request may be deemed to include information coming from a variety of sources including social contact and third party contacts as well as professional engagement and that the lawyer might be criticized or subjected to liability if some of this information is forgotten at the time of the auditor's request.

It is also believed appropriate to recognize that the lawyer will not necessarily have been authorized to investigate, or have investigated, all legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem upon exploration and development. Thus, consideration in the form of preliminary or passing advice, or regarding an incomplete or hypothetical state of facts, or where the lawyer has not been requested to give studied attention to the matter in question, would not come within the concept of "substantive attention" and would therefore be excluded. Similarly excluded are matters which may have been mentioned by the client but which are not actually being handled by the lawyer. Paragraph 2 undertakes to deal with these concerns.

Paragraph 2 is also intended to recognize the principle that the appropriate lawyer to respond as to a particular loss contingency is the lawyer having charge of the matter for the client (e.g., the lawyer representing the client in a litigation matter and/or the lawyer having overall charge and supervision of the matter), and that the lawyer not having that kind of role with respect to the matter should not be expected to respond merely because of having become aware of its existence in a general or incidental way.

The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.

As the lawyer's response is limited to matters involving his professional engagement as counsel, such response should not include information concerning the client which the lawyer receives in another role. In particular, a lawyer who is also a director or officer of the client would not include information which he received as a director or officer unless the information was also received (or, absent the dual role, would in the normal course be received) in his capacity as legal counsel in the context of his professional engagement. Where the auditor's request for information is addressed to a law firm as a firm, the law firm may properly assume that its response is not expected to include any information which may have been communicated to the particular individual by reason of his serving in the capacity of director or officer of the client. The question of the individual's duty, in his role as a director or officer, is not here addressed.

Paragraph 3 (Response May Cover only Material Items in Certain Cases)

Paragraph 3 makes it clear that the lawyer may optionally limit his responses to those items which are individually or collectively material to the auditor's inquiry. If the lawyer takes responsibility for making a determination that a matter is not material for the purposes of his response to the audit inquiry, he should make it clear that his response is so limited. The auditor, in such circumstance, should properly be entitled to rely upon the lawyer's response as providing him with the necessary corroboration. It should be emphasized that the employment of inside general counsel by the client should not detract from the acceptability of his response since inside general counsel is as fully bound by the professional obligations and responsibilities contained in the Code of Professional Responsibility as outside counsel. If the audit inquiry sets forth a definition of materiality but the lawyer utilizes a different test of materiality, he should specifically so state. The lawyer may wish to reach an understanding with the auditor concerning the test of materiality to be used in his response, but he need not do so if he assumes responsibility for the criteria used in making materiality determinations. Any such understanding with the auditor should be referred to or set forth in the lawyer's response. In this connection, it is assumed that the test of materiality so agreed upon would not be so low in amount as to result in a disservice to the client and an unreasonable burden on counsel.

Paragraph 4 (Limited Responses)

The Statement of Policy is designed to recognize the obligation of the auditor to complete the procedures considered necessary to satisfy himself as to the fair presentation of the company's financial condition and results, in order to render a report which includes an opinion not qualified because of a limitation on the scope of the audit. In this connection, reference is made to SEC Accounting Series Release No. 90 [*Financial Reporting Release No. 1, section 607.01(b)*], in which it is stated:

"A 'subject to' or 'except for' opinion paragraph in which these phrases refer to the scope of the audit, indicating that the accountant has not been able to satisfy himself on some significant element in the financial statements, is not acceptable in certificates filed with the Commission in connection with the public offering of securities. The 'subject to' qualification is appropriate when the reference is to a middle paragraph or to footnotes explaining the status of matters which cannot be resolved at statement date."

Paragraph 5 (Loss Contingencies)

Paragraph 5 of the Statement of Policy summarizes the categories of "loss contingencies" about which the lawyer may furnish information to the auditor. The term loss contingencies and the categories relate to concepts of accounting accrual and disclosure specified for the accounting profession in Statement of Financial Accounting Standards No. 5[b] ("FAS 5") issued by the Financial Accounting Standards Board in March, 1975.

5.1 Accounting Requirements

To understand the significance of the auditor's inquiry and the implications of any response the lawyer may give, the lawyer should be aware of the following accounting concepts and requirements set out in FAS 5:[e]

a. A "loss contingency" is an existing condition, situation or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more events occur or fail to occur. Resolutions of the uncertainty may confirm the loss or impairment of an asset or the incurrence of a liability. (Para. 1)

b. When a "loss contingency" exists, the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. There are three areas within that range, defined as follows:

    i. Probable — "The future event or events are likely to occur."

    ii. Reasonably possible — "The chance of the future event or events occurring is more than remote but less than likely."

    iii. Remote — "The chance of the future event or events occurring is slight." (Para. 3)

[e]Citations are to paragraph numbers of FAS 5.

c. *Accrual* in a client's financial statements by a charge to income of the period will be required if both the following conditions are met:

   i. "Information available prior to issuance of the financial statements indicates that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be *probable* that one or more future events will occur confirming the fact of the loss." (emphasis added; footnote omitted)

   ii. "The amount of loss can be reasonably estimated." (Para. 8)

d. If there is no *accrual* of the loss contingency in the client's financial statements because one of the two conditions outlined in (c) above are not met, disclosure may be required as provided in the following:

   "If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, *disclosure* of the contingency *shall be made when there is at least a reasonable possibility* that a loss or an additional loss may have been incurred. *The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim* or assessment *when there has been no manifestation by potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable*." (emphasis added; footnote omitted) (Para. 10)

e. The accounting requirements recognize or specify that (i) the opinions or views of counsel are not the sole source of audit evidence in making determinations about the accounting recognition or treatment to be given to litigation, and (ii) the fact that the lawyer is notable to express an opinion that the outcome will be favorable does not necessarily require an accrual of a loss. Paragraphs 36 and 37 of FAS 5 state as follows:

   "If the underlying cause of the litigation, claim, or assessment is an event occurring before the date of an enterprise's financial statements, the probability of an outcome unfavorable to the enterprise must be assessed to determine whether the condition in paragraph 8(a) is met. Among the factors that should be considered are the nature of the litigation, claim, or assessment, the progress of the case (including progress after the date of the financial statements but before those statements are issued), the opinions or views of legal counsel and other advisers, the experience of the enterprise in similar cases, the experience of other enterprises, and any decision of the enterprise's management as to how the enterprise intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or a decision to seek an out-of-court settlement). The fact that legal counsel is unable to express an opinion that the outcome will be favorable to the enterprise should not necessarily be interpreted to mean that the condition for accrual of a loss in paragraph 8(a) is met.

"The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by paragraph 10 of this Statement."

f. Paragraph 38 of FAS 5 focuses on certain examples concerning the determination by the enterprise whether an assertion of an *unasserted possible claim* may be considered probable:

"With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual or disclosure would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate, but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10."

For a more complete presentation of FAS 5, reference is made to AU section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board* Accounting Standards

Codification *450,* Contingencies [SAS No. 12 section 337B],[f] in which are set forth excerpts selected by the AICPA as relevant to a Statement on Auditing Standards, issued by its Auditing Standards Executive Committee, captioned "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments."

5.2 Lawyer's Response

Concepts of probability inherent in the usage of terms like "probable" or "reasonably possible" or "remote" mean different things in different contexts. Generally, the outcome of, or the loss which may result from, litigation cannot be assessed in any way that is comparable to a statistically or empirically determined concept of "probability" that may be applicable when determining such matters as reserves for warranty obligations or accounts receivable or loan losses when there is a large number of transactions and a substantial body of known historical experience for the enterprise or comparable enterprises. While lawyers are accustomed to counseling clients during the progress of litigation as to the possible amount required for settlement purposes, the estimated risks of the proceedings at particular times and the possible application or establishment of points of law that may be relevant, such advice to the client is not possible at many stages of the litigation and may change dramatically depending upon the development of the proceedings. Lawyers do not generally quantify for clients the "odds" in numerical terms; if they do, the quantification is generally only undertaken in an effort to make meaningful, for limited purposes, a whole host of judgmental factors applicable at a particular time, without any intention to depict "probability" in any statistical, scientific or empirically-grounded sense. Thus, for example, statements that litigation is being defended vigorously and that the client has meritorious defenses do not, and do not purport to, make a statement about the probability of outcome in any measurable sense.

Likewise, the "amount" of loss — that is, the total of costs and damages that ultimately might be assessed against a client — will, in most litigation, be a subject of wide possible variance at most stages; it is the rare case where the amount is precise and where the question is whether the client against which claim is made is liable either for all of it or none of it.

In light of the foregoing considerations, it must be concluded that, as a general rule, it should not be anticipated that meaningful quantifications of "probability" of outcome or amount of damages can be given by lawyers in assessing litigation. To provide content to the definitions set forth in Paragraph 5 of the Statement of Policy, this Commentary amplifies the meanings of the terms under discussion, as follows:

> *"probable"* — An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factors into account which may affect the outcome, that it is extremely doubtful that the client will prevail.

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[f] Statement on Auditing Standards No. 12 section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board* Accounting Standards Codification *450*, Contingencies, has been withdrawn by this section.

> *"remote"* — The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

In other words, for purposes of the lawyer's response to the request to advise auditors about litigation, an unfavorable outcome will be "probable" only if the chances of the client prevailing appear slight and of the claimant losing appear extremely doubtful; it will be "remote" when the client's chances of losing appear slight and of not winning appear extremely doubtful. It is, therefore, to be anticipated that, in most situations, an unfavorable outcome will be neither "probable" nor "remote" as defined in the Statement of Policy.

The discussion above about the very limited basis for furnishing judgments about the outcome of litigation applies with even more force to a judgment concerning whether or not the assertion of a claim not yet asserted is "probable." That judgment will infrequently be one within the professional competence of lawyers and therefore the lawyer should not undertake such assessment except where such judgment may become meaningful because of the presence of special circumstances, such as catastrophes, investigations and previous public disclosure as cited in Paragraph 5 of the Statement of Policy, or similar extrinsic evidence relevant to such assessment. Moreover, it is unlikely, absent relevant extrinsic evidence, that the client or anyone else will be in a position to make an informed judgment that assertion of a possible claim is "probable" as opposed to "reasonably possible" (in which event disclosure is not required). In light of the legitimate concern that the public interest would not be well served by resolving uncertainties in a way that invites the assertion of claims or otherwise causes unnecessary harm to the client and its stockholders, a decision to treat an unasserted claim as "probable" of assertion should be based only upon compelling judgment.

Consistent with these limitations believed appropriate for the lawyer, he should not represent to the auditor, nor should any inference from his response be drawn, that the unasserted possible claims identified by the client (as contemplated by Paragraph 5(c) of the Statement of Policy) represent all such claims of which the lawyer may be aware or that he necessarily concurs in his client's determination of which unasserted possible claims warrant specification by the client; within proper limits, this determination is one which the client is entitled to make — and should make — and it would be inconsistent with his professional obligations for the lawyer to volunteer information arising from his confidential relationship with his client.

As indicated in Paragraph 5, the lawyer also may be asked to estimate the potential loss (or range) in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the lawyer would provide an estimate only if he believes that the probability of inaccuracy of the estimate of the range or amount is slight. What is meant here is that the estimate of amount of loss presents the same difficulty as assessment of outcome and that the same formulation of "probability" should be used with respect to the determination of estimated loss amounts as should be used with respect to estimating the outcome of the matter.

In special circumstances, with the proper consent of the client, the lawyer may be better able to provide the auditor with information concerning loss contingencies through conferences where there is opportunity for more detailed discussion and interchange. However, the principles set forth in the Statement of Policy and this Commentary are fully applicable to such conferences.

Subsumed throughout this discussion is the ongoing responsibility of the lawyer to assist his client, at the client's request, in complying with the requirements of FAS 5 to the extent such assistance falls within his professional competence. This will continue to involve, to the extent appropriate, privileged discussions with the client to provide a better basis on which the client can make accrual and disclosure determinations in respect of its financial statements.

In addition to the considerations discussed above with respect to the making of any judgment or estimate by the lawyer in his response to the auditor, including with respect to a matter specifically identified by the client, the lawyer should also bear in mind the risk that the furnishing of such a judgment or estimate to any one other than the client might constitute an admission or be otherwise prejudicial to the client's position in its defense against such litigation or claim (see Paragraph 1 of the Statement of Policy and of this Commentary).

Paragraph 6 (Lawyer's Professional Responsibility)

The client must satisfy whatever duties it has relative to timely disclosure, including appropriate disclosure concerning material loss contingencies, and, to the extent such matters are given substantive attention in the form of legal consultation, the lawyer, when his engagement is to advise his client concerning a disclosure obligation, has a responsibility to advise his client concerning its obligations in this regard. Although lawyers who normally confine themselves to a legal specialty such as tax, antitrust, patent or admiralty law, unlike lawyers consulted about SEC or general corporate matters, would not be expected to advise generally concerning the client's disclosure obligations in respect of a matter on which the lawyer is working, the legal specialist should counsel his client with respect to the client's obligations under FAS 5 to the extent contemplated herein. Without regard to legal specialty, the lawyer should be mindful of his professional responsibility to the client described in Paragraph 6 of the Statement of Policy concerning disclosure.

The lawyer's responsibilities with respect to his client's disclosure obligations have been a subject of considerable discussion and there may be, in due course, clarification and further guidance in this regard. In any event, where in the lawyer's view it is clear that (i) the matter is of material importance and seriousness, and (ii) there can be no reasonable doubt that its non-disclosure in the client's financial statements would be a violation of law giving rise to material claims, rejection by the client of his advice to call the matter to the attention of the auditor would almost certainly require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility. (See, e.g., Disciplinary Rule 7-102 (A)(3) and (7), and Disciplinary Rule 2-110 (B)(2).) Withdrawal under such circumstances is obviously undesirable and might present serious problems for the client. Accordingly, in the context of financial accounting and reporting for loss contingencies arising from unasserted claims, the standards for which are contained in FAS

5, clients should be urged to disclose to the auditor information concerning an unasserted possible claim or assessment (not otherwise specifically identified by the client) where in the course of the services performed for the client it has become clear to the lawyer that (i) the client has no reasonable basis to conclude that assertion of the claim is not probable (employing the concepts hereby enunciated) and (ii) given the probability of assertion, disclosure of the loss contingency in the client's financial statements is beyond reasonable dispute required.

Paragraph 7 (Limitation on Use of Response)

Some inquiry letters make specific reference to, and one might infer from others, an intention to quote verbatim or include the substance of the lawyer's reply in footnotes to the client's financial statements. Because the client's prospects in pending litigation may shift as a result of interim developments, and because the lawyer should have an opportunity, if quotation is to be made, to review the footnote in full, it would seem prudent to limit the use of the lawyer's reply letter. Paragraph 7 sets out such a limitation.

Paragraph 7 also recognizes that it may be in the client's interest to protect information contained in the lawyer's response to the auditor, if and to the extent possible, against unnecessary further disclosure or use beyond its intended purpose of informing the auditor. For example, the response may contain information which could prejudice efforts to negotiate a favorable settlement of a pending litigation described in the response. The requirement of consent to further disclosure, or of reasonable advance notice where disclosure may be required by court process or necessary in defense of the audit, is designed to give the lawyer an opportunity to consult with the client as to whether consent should be refused or limited or, in the case of legal process or the auditor's defense of the audit, as to whether steps can and should be taken to challenge the necessity of further disclosure or to seek protective measures in connection therewith. It is believed that the suggested standard of twenty days advance notice would normally be a minimum reasonable time for this purpose.

Paragraph 8 (General)

It is reasonable to assume that the Statement of Policy will receive wide distribution and will be readily available to the accounting profession. Specifically, the Statement of Policy has been reprinted as Exhibit II to the Statement on Auditing Standards, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants. Accordingly, the mechanic for its incorporation by reference will facilitate lawyer-auditor communication. The incorporation is intended to include not only limitations, such as those provided by Paragraphs 2 and 7 of the Statement of Policy, but also the explanatory material set forth in this Commentary.

Annex A

[*Illustrative forms of letters for full response by outside practitioner or law firm and inside general counsel to the auditor's inquiry letter. These illustrative forms, which are not part of the Statement of Policy, have been prepared by the Committee on Audit Inquiry Responses* *solely in order to assist those who may wish to have, for reference purposes, a form of response which incorporates the principles of the Statement of Policy and accompanying Commentary. Other forms of response letters will be appropriate depending on the circumstances.*]

Illustrative Form of Letter for Use by Outside Practitioner or Law Firm:

[*Name and Address of Accounting Firm*]

Re: [*Name of Client*] [*and Subsidiaries*]

Dear Sirs:

By letter date [*insert date of request*] Mr. [*insert name and title of officer signing request*] of [*insert name of client*] [*(the "Company") or (together with its subsidiaries, the "Company")*] has requested us to furnish you with certain information in connection with your examination of the accounts of the Company as at [*insert fiscal year-end*].

[*Insert description of the scope of the lawyer's engagement; the following are sample descriptions:*]

While this firm represents the Company on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Company.

[*or*]

We call your attention to the fact that this firm has during the past year represented the Company only in connection with certain [*Federal income tax matters*] [*litigation*] [*real estate transactions*] [*describe other specific matters, as appropriate*] and has not been engaged for any other purpose.

Subject to the foregoing and to the last paragraph of this letter, we advise you that since [*insert date of beginning of fiscal period under audit*] we have not been engaged to give substantive attention to, or represent the Company in connection with, [*material*][g] loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[*Describe litigation and claims which fit the foregoing criteria.*]

[*If the inquiry letter requests information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations:*]

With respect to the matters specifically identified in the Company's letter and upon which comment has been specifically requested, as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, we advise you, subject to the last paragraph of this letter, as follows:

[*Insert information as appropriate*]

The information set forth herein is [*as of the date of this letter*] [*as of (insert date), the date on which we commenced our internal review procedures for purposes of preparing this*

[g]***Note:*** See Paragraph 3 of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

response], except as otherwise noted, and we disclaim any undertaking to advise you of changes which thereafter may be brought to our attention.

[*Insert information with respect to outstanding bills for services and disbursements.*]

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Company's request, this will confirm as correct the Company's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.[b] [*Describe any other or additional limitation as indicated by Paragraph 4 of the Statement*]

Very truly yours,

Illustrative Form of Letter for Use by Inside General Counsel:

[*Name and Address of Accounting Firm*]

Re: [*Name of Company*] [*and Subsidiaries*]

Dear Sirs:

As General Counsel[h] of [*insert name of client*] [*(the "Company")*] [*(together with its subsidiaries, the "Company")*], I advise you as follows in connection with your examination of the accounts of the Company as at [*insert fiscal year-end*].

I call your attention to the fact that as General Counsel[h]for the Company I have general supervision of the Company's legal affairs. [*If the general legal supervisory responsibilities of the person signing the letter are limited, set forth here a clear description of those legal matters over which such person exercises general supervision, indicating exceptions to such supervision and situations where primary reliance should be placed on other sources.*] In such capacity, I have reviewed litigation and claims threatened or asserted involving the Company and have consulted with outside legal counsel with respect thereto where I have deemed appropriate.

Subject to the foregoing and to the last paragraph of this letter, I advise you that since [*insert date of beginning of fiscal period under audit*] neither I, nor any of the lawyers over whom I exercise general legal supervision, have given substantive attention to, or represented the Company in connection with, [*material*][g] loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[*Describe litigation and claims which fit the foregoing criteria.*]

[*If information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations is to be supplied:*]

With respect to matters which have been specifically identified as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, I advise you, subject to the last paragraph of this letter, as follows:

[*Insert information as appropriate*]

The information set forth herein is [*as of the date of this letter*] as of [*insert date*], the date on which we commenced our internal review procedures for purposes of preparing this response, except as otherwise noted, and I disclaim any undertaking to advise you of changes which thereafter may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision.

[h]It may be appropriate in some cases for the response to be given by inside counsel other than inside general counsel, in which event this letter should be appropriately modified.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy, this will confirm as correct the Company's understanding that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, I, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.[b][*Describe any other or additional limitation as indicated by Paragraph 4 of the Statement.*]

Very truly yours,

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit B — Report of the Subcommittee on Audit Inquiry Responses[1]

.A91 Because of a recent court case and other judicial decisions involving lawyers' responses to auditors' requests for information, an area of uncertainty or concern has been brought to the Subcommittee's attention and is the subject of the following comment:

This Committee's report does not modify the ABA Statement of Policy, nor does it constitute an interpretation thereof. The Preamble to the ABA Statement of Policy states as follows:

> Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political, and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and to act in accordance with counsel's advice.

Paragraph 1 of the ABA Statement of Policy provides as follows:

1. *Client Consent to Response*. The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept

[1] Excerpted from "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," *The Business Lawyer* 31, no. 3 (1976). Reprinted by permission of the American Bar Association.

established by Statement of Financial Accounting Standards No. 5, promulgated by the Financial Accounting Standards Board in March 1975 and discussed in Paragraph 5.1 of the accompanying commentary), to the extent hereinafter set forth, subject to the following:

a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.

b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.

d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

In order to preserve explicitly the evidentiary privileges, some lawyers have suggested that clients include language in the following or substantially similar form:

> We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

If client's request letter does not contain language similar to that in the preceding paragraph, the lawyer's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the lawyer, in writing or orally, in other communications or in discussions.

For the same reason, the response letter from some lawyers also includes language in the following or substantially similar form:

> The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

We believe that language similar to the foregoing in letters of the client or the lawyer simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver. It follows that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges.

On the other hand, the inclusion of such language does not necessarily assure the client that, depending on the facts and circumstances, a waiver may not be found by a court of law to have occurred.

We do not believe that the foregoing types of inclusions cause a negative impact upon the public policy considerations described in the Preamble to the ABA Statement of Policy nor do they intrude upon the arrangements between the legal profession and the accounting profession contemplated by the ABA Statement of Policy. Moreover, we do not believe that such language interferes in any way with the standards and procedures of the accounting profession in the auditing process nor should it be construed as a limitation upon the lawyer's reply to the auditors. We have been informed that the Auditing Standards Board of the AICPA has adopted an interpretation of SAS 12 recognizing the propriety of these statements.

Lawyers, in any case, should be encouraged to have their draft letters to auditors reviewed and approved by the client before releasing them to the auditors and may wish to explain to the client the legal consequences of the client's consent to lawyer's response as contemplated by subparagraph 1(d) of the Statement of Policy.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

Exhibit C — Statement on Updates to Audit Response Letters[a]

.A92 *By Audit Responses Committee, ABA Business Law Section*

Requests for updates to lawyers' audit response letters have become more frequent in recent years. Typically, the client's audit inquiry letter to its lawyers calls for a response before the anticipated issuance date of the audited financial statements. An "update" or "bringdown" is an audit response letter provided to the auditor in which a lawyer provides information about loss contingencies as of a date after the date of the lawyer's initial response to the audit inquiry letter and any previous update.

The *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests*[1] does not specifically discuss updates to audit response letters. In view of the increased frequency of update requests and the lack of guidance regarding these requests, the ABA Business Law Section Audit Responses Committee has prepared this statement to outline the reasons auditors seek updates of audit response letters and to present the Committee's views on appropriate practices for responding to update requests under the *ABA Statement of Policy*. The Committee hopes that the guidance provided in this Statement will enhance the ability of lawyers to respond efficiently to update requests, thereby facilitating the audit process and contributing to audit quality.

The Reasons for Update Requests

The *ABA Statement of Policy*, including its reference to accounting and auditing standards, provides the framework for lawyers' audit response letters. The *ABA Statement of Policy* recognizes the fundamental importance to the American legal system of maintaining client confidences. It makes clear that lawyers may provide information to auditors only at the request, and with the express consent, of their clients.[2] In accordance with the *ABA Statement of Policy*, lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.[3] The *ABA Statement of Policy* also contemplates that "the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning" loss contingencies.[4]

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[1]*American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) [hereinafter *ABA Statement of Policy*], *reprinted in* ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK 1 (2d ed. 2013).

[2]*Id.* at 2–3 (¶ 1).

[3]*Id.* at 3 (¶ 2) ("It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention.").

In recent years, requests for updates have become standard procedure for many auditors. This reflects changes in applicable accounting standards and auditing practices, as well as increased emphasis on loss contingencies by the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"), which in turn has increased auditors' focus on loss contingencies. Requests for updates to audit response letters typically are made in three contexts:

- *Audit of annual financial statements.* Changes to financial reporting standards require the entity's management to evaluate "subsequent events," which can include changes in loss contingencies, through the date the financial statements are issued or are available to be issued.[5]

  As a result of changes in auditing practices,[6] most auditors' reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which fieldwork is completed. Accordingly, the auditor may seek to obtain audit evidence, in the form of audit letter updates, to corroborate

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[4]*Id.* Although a law firm's or law department's internal review procedure may include canvassing lawyers who performed services for a client from the beginning of the fiscal period under audit, many firms or departments limit their response to matters existing at the end of that period or arising after the end of the period. This approach is based upon the statement in the typical request letter to the effect that the response should include matters that existed at the end of the fiscal period under audit and during the period from that date to the date as of which the response is given. See INTERIM AUDITING STANDARDS, AU § 337A (Pub. Co. Accounting Oversight Bd. 2003) (illustrative audit inquiry letter); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 501.A69 (Am. Inst. of Certified Pub. Accountants 2011) (illustrative audit inquiry letter). Thus, under this approach, matters resolved during the fiscal period, which no longer comprise "loss contingencies" at or after the fiscal period end date, are not reported.

[5]See SUBSEQUENT EVENTS, Accounting Standards Codification, Topic 855 (Fin. Accounting Standards Bd. 2010) [hereinafter ASC 855]. ASC 855 codifies a prior accounting standard on subsequent events. See SUBSEQUENT EVENTS, Statement of Fin. Accounting Standards, No. 165 (Fin. Accounting Standards Bd. 2009) [hereinafter SFAS 165]. Notably, SFAS 165 amended the accounting standard governing contingencies. See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975), amended by SFAS 165, ¶ B3 (codified as CONTINGENCIES, Accounting Standards Codification, Topic 450 (Fin. Accounting Standards Bd. 2009)) [hereinafter ASC 450]. As amended, ASC 450 provides that, in assessing the accounting for a loss contingency, the reporting entity must consider information available through the date the financial statements were issued or available to be issued. *See id.* 450-20-25. Under ASC 855, for SEC filers, financial statements are "issued" on the date they are filed with the SEC; for non-SEC filers, they are "available to be issued" when they are complete and all internal approvals for issuance have occurred. ASC 855-10-25. ASC 855 also requires that entities disclose in the financial statements the date through which they evaluated subsequent events. *See id.* 855-10-50.

[6]In connection with its adoption of Auditing Standard No. 5 in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard AU 530 to provide that "the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion." INTERIM AUDITING STANDARDS, AU § 530.01 (Pub. Co. Accounting Oversight Bd. 2007). Previously, AU 530 had provided that generally the date of completion of the field work should be used as the date of the report. See Proposed Auditing Standard — An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), *available at*http://pcaobus.org/Rules/Documents/2006-12-19_Release_No._2006-007.pdf. The PCAOB also amended its Interim Auditing Standards to provide that "the latest date of the period covered by the lawyer's response (the 'effective date') should be as close to the date of the auditor's report as is practicable in the circumstances." INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2007). Previously, the standard had said that the effective date should be "as close to the completion of field work" as practicable in the circumstances. INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2003).

management's identification of and accounting for loss contingencies as of the issuance date.

- *Review of quarterly financial statements*. As with annual financial statements, an entity is required to consider subsequent events, including loss contingencies, through the date of issuance of its quarterly financial statements. SEC rules require that quarterly financial statements be reviewed by the entity's external auditors in accordance with relevant auditing standards.[7] Although they are not ordinarily required to do so,[8] auditors may request confirmation from counsel about loss contingencies as part of their internal procedures before they will sign off on the filing of quarterly financial statements with the SEC.

- *Consents in connection with registered securities offerings*. Auditors must consent to the use of their audit reports in registration statements for public offerings of securities. Auditing standards require the auditors to perform certain procedures before consenting to the inclusion of a previously issued audit report in a registration statement or amendment to a registration statement.[9] Although these standards do not require an auditor to make inquiries of lawyers, before issuing a consent, many auditors ask lawyers to update their audit response letters. In offerings involving shelf takedowns, the auditors may request one or more updates in connection with their delivery of "comfort letters" to underwriters.

The foregoing explains the increased frequency of auditors' requests for updates. However, the experience of many lawyers suggests that auditors (and sometimes clients) do not always appreciate the need for lawyers to perform internal procedures to be able to deliver an update.

Lawyers' Responses to Update Requests — A Framework

A lawyer's update to an audit response letter is subject to the *ABA Statement of Policy* and should be prepared and delivered in accordance with its terms. This has several implications.

Client Requests for Updates to Audit Response Letters. As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. The lawyer should be satisfied that the client has provided the necessary authorization for the update. The Committee does not believe that any specific form of authorization is necessary, so long as it expresses the client's intent that the lawyer deliver an update to the lawyer's response letter to the

[7]Regulation S-X, Rule 10-01(d), 17 C.F.R. § 210.10-01(d) (2014).

[8]*See* INTERIM AUDITING STANDARDS, AU § 722.20 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF AUDITING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 100, AU § 722.20 (Am. Inst. of Certified Pub. Accountants 2002), *superseded by* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 930.15 (Am. Inst. of Certified Pub. Accountants 2011).

[9]*See* INTERIM AUDITING STANDARDS, AU § 711 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 925 (Am. Inst. of Certified Pub. Accountants 2011).

auditor. A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such requests.

Standing Requests. In some cases, a client's initial request letter may contain a standing request that the lawyer deliver updates to response letters upon request by the auditor. The inclusion of such a request can facilitate the audit response process. Many lawyers view a client request to provide information to the auditors in connection with the audit of the annual financial statements to include an implicit standing request to respond to update requests related to issuance of those financial statements. Other lawyers require a separate authorization for every update, absent a standing request.

The Committee believes that lawyers may provide an update on the basis of a standing request, but recognizes that in some circumstances they may want a specific request or consent from the client. Among those circumstances are (1) when significant time has elapsed since the initial request, and (2) when developments have occurred that would be required to be reported in the update, such as pending or threatened litigation that has arisen since the previous response or significant developments in previously described pending or threatened litigation, and the lawyer believes the client should be consulted before issuing the update response.

Preparation of Updates to Audit Response Letters. The Committee recognizes that circumstances may allow lawyers significantly less time to prepare an update than they had for the initial response letter. Still, clients and auditors should recognize that because, from the lawyers' standpoint, each update is tantamount to reissuance of the initial response letter, lawyers may have to perform internal review procedures similar to those performed for the initial response letter. Those may include inquiring again of lawyers in the law firm or law department who may have relevant information. Clients should be encouraged to communicate with their lawyers and the auditor when the client becomes aware of a filing or transaction that will require an update to an audit response letter, so that the lawyers have adequate time to perform sufficient internal review procedures to provide the update.[10]

The internal procedures lawyers perform to issue an update will depend on the particular circumstances and the professional judgment of the lawyers involved as to what is necessary. For example, some law firms or law departments may canvass the lawyers who provided information reflected in the earlier response to the audit inquiry letter, even if those lawyers have not subsequently recorded time for the client. Other firms or law departments may only canvass lawyers who have performed legal services for the client since the cutoff date for the last internal inquiry and any other lawyers they believe are likely to have relevant information. The Committee believes that either approach is

[10]See *ABA Statement of Policy, supra* note 1, at 9–10 (commentary ¶ 2) ("The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.").

acceptable. The Committee recognizes that the professional judgment of lawyers may lead to different procedures in particular cases, which might involve varying types and amount of inquiry and documentation.

Form of Updates to Audit Response Letters. Updates ordinarily should be delivered in writing, not communicated orally. Any update to an audit response letter should be made in accordance with the *ABA Statement of Policy*, including its conditions and limitations. Unlike lawyers' initial responses to audit inquiry letters, no illustrative form of update response has been established, and many different forms are in common use.

Some lawyers regularly use a "long form" response letter that employs the same form as the initial response letter but provides information about loss contingencies as of an effective date after the effective date of the previous letter. Others use a "short form" letter that does not contain all the language of a long-form letter, but rather references the information in the previous letter and identifies any reportable developments with respect to previously reported loss contingencies or reportable loss contingencies that have arisen since the prior effective date. Finally, some lawyers have adopted a hybrid approach under which they use a short form in some circumstances and a long form in others; these lawyers may use a short form when they have no developments to report since the previous response letter and a long form when additional information about loss contingencies (whether previously reported or new) needs to be reported.

If a short form is used, the Committee suggests that it should (1) refer to the relevant client request(s), the entity or entities covered by the response, and the most recent long form response letter and previous update letters, if any, identifying them by date, and (2) state expressly that the response is subject to the same limitations and qualifications contained in the earlier letter. Nothing in this statement is intended to limit the professional judgment of a lawyer regarding the form the lawyer uses to update an audit response letter.

[Paragraph added, June 2015, to reflect *Statement on Updates to Audit Response Letter* by the Audit Responses Committee of the American Bar Association. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

AU-C Section 505

External Confirmations

Source: SAS No. 122; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's use of external confirmation procedures to obtain audit evidence, in accordance with the requirements of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, and section 500, *Audit Evidence*. It does not address inquiries regarding litigation, claims, and assessments, which are addressed in section 501, *Audit Evidence—Specific Considerations for Selected Items*. [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

External Confirmation Procedures to Obtain Audit Evidence

.02 Section 500 indicates that the reliability of audit evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained.[1] Section 500 also includes the following generalizations applicable to audit evidence:[2]

- Audit evidence is more reliable when it is obtained from external parties.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper or electronic.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This section is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence. [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[1]Paragraph .A22 of section 500, *Audit Evidence*. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[2]Paragraphs .A22–.A24 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.03 Other AU-C sections recognize the importance of external confirmations as audit evidence; for example

- section 330 discusses the auditor's responsibility (*a*) to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and (*b*) to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.[3,4] The auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless
  - — the overall account balance is immaterial,
  - — external confirmation procedures would be ineffective, or
  - — the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.[5]
- section 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.[6] To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Section 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.[7]
- section 240, *Consideration of Fraud in a Financial Statement Audit*, indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.[8]
- section 500 indicates that external confirmations need not be restricted to classes of transactions, account balances, or disclosures. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain

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[3]Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.*

[4][Footnote deleted by the issuance of SAS No. 145, October 2021.]

[5]Paragraphs .19–.20 of section 330.

[6]Paragraph .07*b* of section 330.

[7]Paragraph .A58 of section 330.

[8]Paragraph .A43 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

conditions (for example, the absence of a side agreement that may influence revenue recognition).[9]

[Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.05 The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Exception. A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

External confirmation. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium (for example, through the auditor's direct access to information held by a third party). (Ref: par. .A1)

Negative confirmation request. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Nonresponse. A failure of the confirming party to respond, or fully respond, to a positive confirmation request or a confirmation request returned undelivered.

Positive confirmation request. A request that the confirming party respond directly to the auditor by providing the requested information or indicating whether the confirming party agrees or disagrees with the information in the request.

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[9]Paragraph .A15 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

Requirements

External Confirmation Procedures

.07 When using external confirmation procedures, the auditor should maintain control over external confirmation requests, including

a. determining the information to be confirmed or requested; (Ref: par. .A2)

b. selecting the appropriate confirming party; (Ref: par. .A3)

c. designing the confirmation requests, including determining that requests are properly directed to the appropriate confirming party and provide for being responded to directly to the auditor; and (Ref: par. .A4–.A7)

d. sending the requests, including follow-up requests, when applicable, to the confirming party. (Ref: par. .A8)

Management's Refusal to Allow the Auditor to Perform External Confirmation Procedures

.08 If management refuses to allow the auditor to perform external confirmation procedures, the auditor should

a. inquire about management's reasons for the refusal and seek audit evidence about their validity and reasonableness; (Ref: par. .A9)

b. evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures; and (Ref: par. .A10)

c. perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: par. .A11)

.09 If the auditor concludes that management's refusal to allow the auditor to perform external confirmation procedures is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor should communicate with those charged with governance, in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*.[10] The auditor also should determine the implications for the audit and the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[10]Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

.10 If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor should obtain further audit evidence to resolve those doubts. (Ref: par. .A12–.A22)

.11 If the auditor determines that a response to a confirmation request is not reliable, the auditor should evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing, and extent of other audit procedures. (Ref: par. .A23)

Nonresponses and Oral Responses

.12 In the case of each nonresponse, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: par. .A24–.A27)

When a Written Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

.13 If the auditor has determined that a written response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor should determine the implications for the audit and the auditor's opinion, in accordance with section 705. (Ref: par. .A28–.A29)

Exceptions

.14 The auditor should investigate exceptions to determine whether they are indicative of misstatements. (Ref: par. .A30–.A31)

Negative Confirmations

.15 Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor should not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level, unless all of the following are present:

a. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion.

b. The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions, or conditions.

c. A very low exception rate is expected.

d. The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests. (Ref: par. .A32)

Evaluating the Evidence Obtained

.16 The auditor should evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence or whether further audit evidence is necessary. (Ref: par. .A33–.A34)

Application and Other Explanatory Material

Definitions

External Confirmation (Ref: par. .06)

.A1 The auditor's direct access to information held by a third party (the confirming party) may meet the definition of an *external confirmation* when, for example, the auditor is provided by the confirming party with the electronic access codes or information necessary to access a secure website where data that addresses the subject matter of the confirmation is held. The auditor's access to information held by the confirming party may also be facilitated by a third-party service provider. When access codes or information necessary to access the confirming party's data is provided to the auditor by management, evidence obtained by the auditor from access to such information does not meet the definition of an *external confirmation*.

External Confirmation Procedures

Determining the Information to Be Confirmed or Requested (Ref: par. .07a)

.A2 External confirmation procedures frequently are performed to confirm or request information regarding account balances, elements thereof, and disclosures. They also may be used to confirm the terms of agreements, contracts, or transactions between an entity and other parties or to confirm the absence of certain conditions, such as a "side agreement."

Selecting the Appropriate Confirming Party (Ref: par. .07b)

.A3 Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party who the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

Designing Confirmation Requests (Ref: par. .07c)

.A4 The design of a confirmation request may directly affect the confirmation response rate and the reliability and nature of the audit evidence obtained from responses.

.A5 Factors to consider when designing confirmation requests include the following:

- The assertions being addressed.
- Specific identified risks of material misstatement, including fraud risks.
- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.
- The method of communication (for example, in paper form or by electronic or other medium).
- Management's authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

.A6 A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information or asking the confirming party to provide information. A response to a properly designed positive confirmation request ordinarily is expected to provide reliable audit evidence. A risk exists, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request and that ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required from the confirming parties to provide the requested information.

.A7 Determining that requests are properly addressed includes verifying the accuracy of the addresses, including testing the validity of some or all of the addresses on the confirmation requests before they are sent out, regardless of the confirmation method used. When a confirmation request is sent by e-mail, the auditor's determination that the request is being properly directed to the appropriate confirming party may include performing procedures to test the validity of some or all of the e-mail addresses supplied by management. The nature and extent of the necessary procedures is dependent on the risks associated with the particular type of confirmation or address. For example, a confirmation addressing a higher risk assertion or a confirmation address that appears to be potentially less reliable (for example, an electronic confirmation addressed in a manner that appears easier to falsify) may necessitate different or more extensive procedures to determine that the request is directed to the intended recipient. See further guidance in paragraphs .A14–.A15.

Follow-Up on Confirmation Requests (Ref: par. .07d)

.A8 The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having reverified the accuracy of the original address, send an additional or follow-up request.

Management's Refusal to Allow the Auditor to Perform External Confirmation Procedures

Reasonableness of Management's Refusal (Ref: par. .08a)

.A9 A refusal by management to allow the auditor to perform external confirmation procedures is a limitation on the audit evidence the auditor seeks to obtain; therefore, the auditor is required to inquire about the reasons for the limitation. A common reason offered by management is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence about the validity and reasonableness of the reasons for management's refusal because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: par. .08b)

.A10 The auditor may conclude from the evaluation in paragraph .08*b* that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.[11] For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation, in accordance with section 240.[12]

Alternative Audit Procedures (Ref: par. .08c)

.A11 The alternative audit procedures performed may be similar to those appropriate for a nonresponse, as set out in paragraphs .A24–.A27. Such procedures also would take into account the results of the auditor's evaluation in paragraph .08*b*.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests (Ref: par. .10)

.A12 Section 500 indicates that consideration of the sources of information to be used as audit evidence includes the possibility that the information source may not be reliable.[13] All responses carry some risk of interception, alteration, or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include whether it

[11] Paragraph .32 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[12] Paragraph .24 of section 240.

[13] Paragraph .A22 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

- was received by the auditor indirectly or
- appeared not to come from the originally intended confirming party.

[Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.A13 The auditor's consideration of the reliability of the information obtained through the confirmation process to be used as audit evidence includes consideration of the risks that

a. the information obtained may not be from an authentic source,

b. a respondent may not be knowledgeable about the information to be confirmed, and

c. the integrity of the information may have been compromised.

When an electronic confirmation process or system is used, the auditor's consideration of the risks described in *a–c* includes the consideration of risks that the electronic confirmation process is not secure or is improperly controlled.

.A14 Responses received electronically (for example, by fax or e-mail) involve risks relating to reliability because proof of origin or identity of the confirming party may be difficult to establish, and alterations may be difficult to detect. The auditor may determine that it is appropriate to address such risks by utilizing a system or process that validates the respondent or by directly contacting the purported sender (for example, by telephone) to validate the identity of the sender of the response and to validate that the information received by the auditor corresponds to what was transmitted by the sender.

.A15 An electronic confirmation system or process that creates a secure confirmation environment may mitigate the risks of interception or alteration. Creating a secure confirmation environment depends on the process or mechanism used by the auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation. If the auditor is satisfied that such a system or process is secure and properly controlled, evidence provided by responses received using the system or process may be considered reliable. Various means might be used to validate the source of the electronic information. For example, the use of encryption, electronic digital signatures, and procedures to verify website authenticity may improve the security of the electronic confirmation system or process. If a system or process that facilitates electronic confirmation between the auditor and the respondent is in place and the auditor plans to rely on the controls over such a system or process, an assurance trust services report (for example, Systrust) or another assurance report on that system or process may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that system or process. Such an assurance report may address the risks described in paragraph .A13. If these risks are not adequately addressed in such a report, the auditor may perform additional procedures to address those risks.

.A16 The auditor is required by section 500 to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.[14] The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party (for example, as described in paragraph .A14). When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than the auditor), the auditor may request the confirming party to respond in writing directly to the auditor. [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

Disclaimers and Other Restrictions in Confirmation Responses

.A17 A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence. Whether the auditor may rely on the information confirmed and the degree of such reliance will depend on the nature and substance of the restrictive language.

.A18 Restrictions that appear to be boilerplate disclaimers of liability may not affect the reliability of the information being confirmed. Examples of such disclaimers may include the following:

- Information is furnished as a matter of courtesy without a duty to do so and without responsibility, liability, or warranty, express or implied.
- The reply is given solely for the purpose of the audit without any responsibility on the part of the respondent, its employees, or its agents, and it does not relieve the auditor from any other inquiry or the performance of any other duty.

.A19 Other restrictive language also may not affect the reliability of a response if it does not relate to the assertion being tested. For example, in a confirmation of investments, a disclaimer regarding the valuation of the investments may not affect the reliability of the response if the auditor's objective in using the confirmation request is to obtain audit evidence regarding whether the investments exist.

.A20 Certain restrictive language may, however, cast doubt about the completeness or accuracy of the information contained in the response or on the auditor's ability to rely on such information. Examples of such restrictions may include the following:

- Information is obtained from electronic data sources, which may not contain all information in the respondent's possession.
- Information is not guaranteed to be accurate nor current and may be a matter of opinion.
- The recipient may not rely upon the information in the confirmation.

.A21 When the auditor has doubts about the reliability of the response as a result of restrictive language, then, in accordance with paragraph .10, the auditor is required to obtain further audit evidence to resolve those doubts. When the practical effect of the

[14] Paragraph .10 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

restrictive language is difficult to ascertain in the particular circumstances, the auditor may consider it appropriate to seek clarification from the respondent or seek legal advice.

.A22 If the auditor is unable to resolve the doubts about the reliability of a response as a result of restrictive language, then, in accordance with paragraph .11, the auditor is required to evaluate the implications on the assessment of the relevant risks of misstatement, including the risk of fraud, and on the related nature, timing, and extent of other audit procedures. The nature, timing, and extent of such procedures will depend on factors such as the nature of the financial statement item, the assertion being tested, the nature and substance of the restrictive language, and relevant information obtained through other audit procedures.

Unreliable Responses (Ref: par. .11)

.A23 When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with section 315A.[15] For example, an unreliable response may indicate a fraud risk factor that requires evaluation, in accordance with section 240.[16]

Nonresponses and Oral Responses (Ref: par. .12)

.A24 The nature and extent of alternative procedures are affected by the account and assertion in question. Examples of alternative audit procedures the auditor may perform include the following:

- For accounts receivable balances, examining specific subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documentation, or other client documentation providing evidence for the existence assertion
- For accounts payable balances, examining subsequent cash disbursements or correspondence from third parties and other records, such as receiving reports and statements that the client receives from vendors providing evidence for the completeness assertion

.A25 A nonresponse to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level and modify planned audit procedures, in accordance with section 315A.[17] For example, a fewer or greater number of responses to confirmation requests than anticipated may indicate a previously unidentified fraud risk factor that requires evaluation, in accordance with section 240.[18]

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[15] Paragraph .32 of section 315A.

[16] Paragraph .24 of section 240.

[17] Paragraph .32 of section 315A.

[18] Paragraph .24 of section 240.

.A26 The auditor may determine that it is not necessary to perform additional alternative audit procedures beyond the evaluation of the confirmation results if such evaluation indicates that relevant and reliable audit evidence has already been obtained. This may be the case when testing for overstatement of amounts and (*a*) the nonresponses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated and (*b*) the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions.

.A27 An oral response to a confirmation request does not meet the definition of an *external confirmation* because it is not a direct written response to the auditor. Provided that the auditor has not concluded that a direct written response to a positive confirmation is necessary to obtain sufficient appropriate audit evidence, the auditor may take the receipt of an oral response to a confirmation request into consideration when determining the nature and extent of alternative audit procedures required to be performed for nonresponses, in accordance with paragraph .12. The auditor may perform additional procedures to address the reliability of the evidence provided by the oral response, such as initiating a call to the respondent using a telephone number that the auditor has independently verified as being associated with the entity. For example, the auditor might call the main telephone number obtained from a reliable source and ask to be directed to the named respondent instead of calling a direct extension provided by the client or included in the statement or other correspondence received by the entity. The auditor may determine that the additional evidence provided by contacting the respondent directly, together with the evidence upon which the original confirmation request is based (for example, a statement or other correspondence received by the entity), is sufficient appropriate audit evidence. In appropriately documenting the oral response, the auditor may include specific details, such as the identity of the person from whom the response was received, his or her position, and the date and time of the conversation.

When a Written Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .13)

.A28 In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include the following:

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls or the risk of collusion, which can involve employee(s) or management, or both, prevent the auditor from relying on evidence from the entity.

.A29 When the auditor has determined that a written response is necessary to obtain sufficient appropriate audit evidence and the auditor has obtained only an oral response to a confirmation request, the auditor may request the confirming party to respond in writing directly to the auditor. If no such response is received, in accordance with paragraph .13, alternative audit procedures will not provide the audit evidence the auditor requires, and the auditor is required to determine the implications for the audit and the auditor's opinion, in accordance with section 705.

Exceptions (Ref: par. .14)

.A30 Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by section 240 to evaluate whether such misstatement is indicative of fraud.[19] Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

.A31 Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: par. .15)

.A32 The failure to receive a response to a negative confirmation request does not indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor but less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request but less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

Evaluating the Evidence Obtained (Ref: par. .16)

.A33 When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:

a. A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request or providing requested information without exception

b. A response deemed unreliable

c. A nonresponse

[19]Paragraph .35 of section 240.

d. A response indicating an exception

.A34 The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by section 330.[20]

[20]Paragraphs .28–.29 of section 330.

AU-C Section 510

Opening Balances — Initial Audit Engagements, Including Reaudit Engagements

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 138.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. When comparative financial statements are presented, the relevant requirements and guidance for comparative financial statements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, also apply. Section 300, *Planning an Audit*, includes additional requirements and guidance regarding activities prior to starting an initial audit. Section 708, *Consistency of Financial Statements*, also applies with respect to the auditor's evaluation of the consistency of accounting principles between the periods presented and covered by the auditor's opinion. Section A, *Terms of Engagement*, includes requirements and guidance with respect to communications with a predecessor auditor before accepting an initial audit engagement, including a reaudit engagement. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.02 This section, with respect to predecessor auditors, does not apply if the most recent audited financial statements are more than one year prior to the beginning of the earliest period to be audited.

Effective Date

.03 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.04 The objective of the auditor, in conducting an initial audit engagement, including a reaudit engagement, is to obtain sufficient appropriate audit evidence regarding opening balances about whether (Ref: par. .A1)

a. opening balances contain misstatements that materially affect the current period's financial statements and

b. 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.

Definitions

.05 For the purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Initial audit engagement. An engagement in which either (*a*) the financial statements for the prior period were not audited, or (*b*) the financial statements for the prior period were audited by a predecessor auditor.

Opening balances. Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

Predecessor auditor. The auditor from a different audit firm who has reported on the most recent audited financial statements or was engaged to perform but did not complete an audit of the financial statements. (Ref: par. .A2)

Reaudit. An initial audit engagement to audit financial statements that have been previously audited by a predecessor auditor.

Requirements

Audit Procedures

.06 The auditor should read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures, and consistency in the application of accounting policies.

.07 In instances in which the prior period financial statements were audited by a predecessor auditor, the auditor should request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. (Ref: par. .A3–.A11)

Opening Balances

.08 The auditor should obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by

a. determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

b. determining whether the opening balances reflect the application of appropriate accounting policies; and

c. evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances and performing one or both of the following: (Ref: par. .A7–.A9 and .A12–.A14)

   i. When the prior year financial statements were audited, reviewing the predecessor auditor's audit documentation to obtain evidence regarding the opening balances

   ii. Performing specific audit procedures to obtain evidence regarding the opening balances

.09 If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor should perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor should communicate the misstatements to the appropriate level of management and those charged with governance, in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*. If the prior period financial statements were audited by a predecessor auditor, the auditor should also refer to paragraphs .12–.13.

Consistency of Accounting Policies

.10 The auditor should obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements and whether changes in the accounting policies have been appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Relevant Information in the Predecessor Auditor's Report

.11 If the prior period's financial statements were audited by a predecessor auditor, and a modification was made to the opinion, the auditor should evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor

.12 If the auditor becomes aware of information during the audit that leads the auditor to believe that financial statements reported on by the predecessor auditor may require revision, the auditor should request management to inform the predecessor auditor of the situation and arrange for the three parties to discuss this information and attempt to resolve the matter. The auditor should communicate to the predecessor auditor information that the auditor believes the predecessor auditor may need to consider, in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*, which addresses the auditor's responsibilities when facts 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 amend the auditor's report. (Ref: par. .A15)

.13 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision or if the auditor is not satisfied with the resolution of the matter, the auditor should evaluate (*a*) the implications on the current engagement and (*b*) whether to withdraw from the engagement or, when withdrawal is not possible under applicable law or regulation, disclaim an opinion on the financial statements. (Ref: par. .A16)

Audit Conclusions and Reporting

.14 The auditor should not make reference to the report or work of the predecessor auditor as the basis, in part, for the auditor's own opinion.

Opening Balances

.15 If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor should express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A17)

.16 If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or adequately presented or disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Consistency of Accounting Policies

.17 If the auditor concludes that

a. the current period's accounting policies are not consistently applied regarding opening balances, in accordance with the applicable financial reporting framework, or

b. a change in accounting policies is not appropriately accounted for or adequately presented or disclosed, in accordance with the applicable financial reporting framework,

the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Modification to the Opinion in the Predecessor Auditor's Report

.18 If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor should modify the auditor's opinion on the current period's financial statements, in accordance with section 705. (Ref: par. .A18)

Application and Other Explanatory Material

Objective (Ref: par. .04)

.A1 Audit evidence regarding opening balances and the consistency of accounting principles may include the most recent audited financial statements, the predecessor auditor's report thereon, the results of inquiry of the predecessor auditor, the results of the auditor's review of the predecessor auditor's audit documentation relating to the most recently completed audit, and audit procedures performed on the current period's transactions that may provide evidence about the opening balances or consistency.

Definitions

Predecessor Auditor (Ref: par. .05)

.A2 Two predecessor auditors may exist: the auditor who reported on the most recent audited financial statements and the auditor who was engaged to perform, but did not complete, an audit of any subsequent financial statements.

Audit Procedures (Ref: par. .07)

.A3 The auditor may initiate communications with management to authorize review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, either before or after accepting the engagement. Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor.

.A4 The predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. Exhibit B, "Illustrative Entity Consent and Acknowledgment Letter," contains an illustrative entity consent and acknowledgment letter.

.A5 It is customary for the predecessor auditor to make himself or herself available to the auditor and to make available for review certain audit documentation. The predecessor auditor determines which audit documentation is to be made available for review and which may be copied. The predecessor auditor ordinarily permits the auditor to review audit documentation, including documentation of planning; risk assessment procedures; further audit procedures; audit results; and other matters of continuing accounting and auditing significance, such as the schedule of uncorrected misstatements, working paper analysis of balance sheet accounts, and those relating to contingencies, related parties, and significant unusual transactions. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A6 Before permitting access to the audit documentation, the predecessor auditor may request written confirmation of the auditor's agreement regarding the use of the audit documentation. Exhibit C, "Illustrative Successor Auditor Acknowledgment Letter," contains an illustrative successor auditor acknowledgment letter.

.A7 The extent, if any, to which a predecessor auditor permits access to the audit documentation or responds to inquiries from the auditor is a matter of the predecessor auditor's professional judgment. The predecessor auditor's denial or limitation of access may affect the auditor's assessment of risk regarding the opening balances or the nature, timing, and extent of the auditor's procedures with respect to the opening balances and consistency of accounting principles. (Ref: par. .07 and .08*c*)

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor's audit documentation for information relevant to planning and performing the audit. The auditor's determination whether to use information resulting from such review as part of the auditor's risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor's assessment of the professional competence and independence of the predecessor auditor. Although the predecessor auditor is not a component auditor, as defined in section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, the auditor may make inquiries similar to those listed in section 600A concerning the professional competence and independence of the predecessor auditor.[1] (Ref: par. .07 and .08*c*)

.A9 The auditor's review of the predecessor auditor's audit documentation may provide audit evidence about the opening balances and consistency of accounting principles.

However, the nature, timing, and extent of audit work performed and the conclusions reached are solely the responsibility of the auditor, as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. (Ref: par. .07 and .08*c*)

Considerations Specific to Governmental Entities (Ref: par. .07)

.A10 In audits of governmental entities, law or regulation may limit the information that the auditor can obtain from a predecessor auditor. Certain information may be identified as classified or otherwise prohibited from disclosure by federal, state, or local laws or public safety or security concerns. For example, if a governmental entity that has previously been audited by a government audit organization (for example, the U.S. Government Accountability Office, a federal inspector general, an elected or statutorily appointed state auditor general, or other suitably qualified audit organization) engages a public accounting firm, the amount of access to audit documentation or other information that the government audit organization can provide an incoming auditor may be constrained by privacy or confidentiality laws or regulations. In situations when communications with a predecessor auditor are restricted, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the effect on the auditor's opinion, in accordance with the requirement in paragraph .15.

.A11 If a government audit organization engages a public accounting firm in an agency capacity to perform an audit of a governmental entity and such firm did not audit the financial statements of the governmental entity in the prior period, this is usually regarded as a change in auditors; therefore, this section applies.

Opening Balances (Ref: par. .08c)

.A12 The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as the following:

- The accounting policies followed by the entity
- The nature of the account balances, classes of transactions and disclosures, and the risks of material misstatement in the current period's financial statements
- The significance of the opening balances relative to the current period's financial statements
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified

.A13 For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness, and

[1]Paragraph .22 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

valuation at the beginning of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures, such as one or more of the following, may be necessary to obtain sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities
- Performing audit procedures on the valuation of the opening inventory items
- Performing audit procedures on gross profit and cutoff

.A14 For noncurrent assets and liabilities, such as property, plant, and equipment; investments; and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties (for example, for long-term debt and investments). In other cases, the auditor may need to carry out additional audit procedures.

Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor

.A15 Section 560 provides reporting guidance to the predecessor auditor who is requested to reissue a previously issued report on financial statements of a prior period when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period.[2]Section 700 and section 703, as applicable, provides reporting guidance to the auditor reporting on comparative financial statements when the predecessor auditor is unable or unwilling to reissue the auditor's report on prior period financial statements that have been restated.[3] (Ref: par. .12) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A16 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision, or if the auditor is not satisfied with the resolution of the matter, the auditor may seek legal advice in determining an appropriate course of action, including evaluating whether to withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .13)

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[2]Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[3]Paragraph .A75 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .A129 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Audit Conclusions and Reporting

Opening Balances (Ref: par. .15)

.A17 Section 705 addresses circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

a. A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances.

b. An opinion that is qualified or disclaimed, as appropriate, regarding the results of operations and cash flows, when relevant, and unmodified regarding financial position. Exhibit A, "Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Position," includes such an illustrative report.

.A18 If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Modification to the Opinion in the Predecessor Auditor's Report (Ref: par. .18)

.A19 In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case when, for example, there was a scope limitation in the prior period but the matter giving rise to the scope limitation has been resolved in the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Exhibit A — Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Position

.A20 Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section A, *Terms of Engagement*.
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material and pervasive to the entity's results of operations and cash flows.[1]
- The financial position at year-end is fairly presented.
- A disclaimer of opinion regarding the results of operations and cash flows and an unmodified opinion regarding financial position is considered appropriate in the circumstances.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

[1] If the possible effects, in the auditor's professional judgment, are considered to be material but not pervasive to the entity's results of operations and cash flows, the auditor would express a qualified opinion on the results of operations and cash flows.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinions

We have audited the balance sheet of ABC Company as of December 31, 20X1, and were engaged to audit the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Disclaimer of Opinion on the Results of Operations and Cash Flows

We do not express an opinion on the results of operations and cash flows of ABC Company for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows for the year ended December 31, 20X1.

Opinion on the Financial Position

In our opinion, the balance sheet presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows

We were not engaged as auditors of the Company until after December 31, 20X0, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by performing other auditing procedures concerning the inventory held at December 31, 20X0. Since opening inventories enter into the determination of net income and cash flows, we were unable to determine whether any adjustments might have been necessary in respect of the profit for the year reported in the income statement and the net cash flows from operating activities reported in the cash flow statement.

Basis for Opinion on the Financial Position

We conducted our audit of the balance sheet in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

[2]The subtitle "Report on the Audit of Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the financial position.

Responsibility of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the Company's financial statements in accordance with auditing standards generally accepted in the United States of America. However, because of the matters described in the Basis for Opinions section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose

of expressing an opinion on the effectiveness of ABC Company's internal control.[3] Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

[3] In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Exhibit B — Illustrative Entity Consent and Acknowledgment Letter (Ref: par. .07 and .A4)

.A21 Paragraph .07 requires that the auditor request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. Paragraph .A4 states that the predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. The following letter is presented for illustrative purposes only and is not required by professional standards.

[*Date*]

ABC Enterprises

[*Address*]

You have given your consent to allow [*name of successor CPA firm*], as independent auditors for ABC Enterprises (ABC), access to our audit documentation for our audit of the December 31, 20X1, financial statements of ABC. You also have given your consent to us to respond fully to [*name of successor CPA firm*] inquiries. You understand and agree that the review of our audit documentation is undertaken solely for the purpose of obtaining an understanding about ABC and certain information about our audit to assist [*name of successor CPA firm*] in planning and performing the audit of the December 31, 20X2, financial statements of ABC.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Attached is the form of the letter we will furnish [*name of successor CPA firm*] regarding the use of the audit documentation.

Very truly yours,

[*Predecessor Auditor*]

By: ______________________________

Accepted:

ABC Enterprises

By: ______________________________

Date: ___________________

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Exhibit C — Illustrative Successor Auditor Acknowledgment Letter (Ref: par. .A6)

.A22 Paragraph .A6 states that the predecessor auditor may request that the auditor confirm in writing his or her agreement regarding the use of the predecessor auditor's audit documentation before permitting access to it. The following letter is presented for illustrative purposes only and is not required by professional standards.

[*Date*]

[*Successor Auditor*]

[*Address*]

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the December 31, 20X1, financial statements of ABC Enterprises (ABC). We rendered a report on those financial statements and have not performed any audit procedures subsequent to the audit report date. In connection with your audit of ABC's 20X2 financial statements, you have requested access to our audit documentation prepared in connection with that audit. ABC has authorized our firm to allow you to review that audit documentation.

Our audit, and the audit documentation prepared in connection therewith, of ABC's financial statements were not planned or conducted in contemplation of your review. Therefore, items of possible interest to you may not have been specifically addressed. Our use of professional judgment and the assessment of audit risk and materiality for the purpose of our audit mean that matters may have existed that would have been assessed differently by you. We make no representation about the sufficiency or appropriateness of the information in our audit documentation for your purposes.

We understand that the purpose of your review is to obtain information about ABC and our 20X1 audit results to assist you in planning and performing your 20X2 audit of ABC. For that purpose only, we will provide you access to our audit documentation that relates to that objective.

Upon request, we will provide copies of audit documentation that provides factual information about ABC. You agree to subject any such copies or information otherwise derived from our audit documentation to your normal policy for retention of audit documentation and protection of confidential entity information. Furthermore, in the event of a third-party request for access to your audit documentation prepared in connection with your audits of ABC, you agree to obtain our permission before voluntarily allowing any such access to our audit documentation or information otherwise derived from our audit documentation, and to obtain on our behalf any releases that you obtain from such third party. You agree to advise us promptly and provide us a copy of any subpoena, summons, or other court order for access to your audit documentation that include copies of our audit documentation or information otherwise derived therefrom.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Very truly yours,

[*Predecessor Auditor*]

By: ____________________________

Accepted:

[*Successor Auditor*]

By: __________________________

Date: __________________

Even with management's consent, access to the predecessor auditor's audit documentation may still be limited. Experience has shown that the predecessor auditor may be willing to grant broader access if given additional assurance concerning the use of the audit documentation. Accordingly, the auditor might consider agreeing to the following additional limitations on the review of the predecessor auditor's audit documentation in order to obtain broader access:

- The auditor will not comment, orally or in writing, to anyone as a result of the review about whether the predecessor auditor's engagement was performed in accordance with generally accepted auditing standards.
- The auditor will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of the predecessor auditor's audit.
- The auditor accepts sole responsibility for the nature, timing, and extent of audit work performed and the conclusions reached in expressing an opinion on the 20X2 financial statements of ABC.

The following paragraph illustrates the previous text:

Because your review of our audit documentation is undertaken solely for the purpose described previously and may not entail a review of all our audit documentation, you agree that (1) the information obtained from the review will not be used by you for any other purpose, (2) you will not comment, orally or in writing, to anyone as a result of that review about whether our audit was performed in accordance with generally accepted auditing standards, (3) you will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of our audit, and (4) you accept sole responsibility for the nature, timing and extent of audit work performed and the conclusions reached in expressing your opinion on the 20X2 financial statements of ABC.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

AU-C Section 520

Analytical Procedures

Source: SAS No. 122.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's use of analytical procedures as substantive procedures (substantive analytical procedures). It also addresses the auditor's responsibility to perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements. Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses the use of analytical procedures as risk assessment procedures (which may be referred to as analytical procedures used to plan the audit).[1] Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the nature, timing, and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.[2]

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.03 The objectives of the auditor are to

a. obtain relevant and reliable audit evidence when using substantive analytical procedures and

b. design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: par. .A1)

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[1] Paragraph .06*b* of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[2] Paragraphs .06 and .18 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

Definition

.04 For the purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. (Ref: par. .A2–.A6)

Requirements

Substantive Analytical Procedures

.05 When designing and performing analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with section 330, the auditor should[3] (Ref: par. .A7–.A9)

a. determine the suitability of particular substantive analytical procedures for given assertions, taking into account the assessed risks of material misstatement and tests of details, if any, for these assertions; (Ref: par. .A10–.A16)

b. evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available and controls over preparation; (Ref: par. .A17–.A20)

c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise (taking into account whether substantive analytical procedures are to be performed alone or in combination with tests of details) to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and (Ref: par. .A21–.A23)

d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph .07 and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations. (Ref: par. .A24)

Analytical Procedures That Assist When Forming an Overall Conclusion

.06 The auditor should design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: par. .A25–.A27)

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[3]Paragraph .18 of section 330.

Investigating Results of Analytical Procedures

.07 If analytical procedures performed in accordance with this section identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor should investigate such differences by

a. inquiring of management and obtaining appropriate audit evidence relevant to management's responses and

b. performing other audit procedures as necessary in the circumstances. (Ref: par. .A28–.A29)

Documentation (Ref: par. .A30)

.08 When substantive analytical procedures have been performed, the auditor should include in the audit documentation the following:[4]

a. The expectation referred to in paragraph .05*c* and the factors considered in its development when that expectation or those factors are not otherwise readily determinable from the audit documentation

b. Results of the comparison referred to in paragraph .05*d* of the recorded amounts, or ratios developed from recorded amounts, with the expectations

c. Any additional auditing procedures performed in accordance with paragraph .07 relating to the investigation of fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount and the results of such additional procedures

Application and Other Explanatory Material

Objectives (Ref: par. .03b)

.A1 Analytical procedures performed near the end of the audit are intended to corroborate audit evidence obtained during the audit of the financial statements to assist the auditor in drawing reasonable conclusions on which to base the auditor's opinion.

Definition (Ref: par. .04)

.A2 Analytical procedures include the consideration of comparisons of the entity's financial information with, for example

- comparable information for prior periods.
- anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.

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[4]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable and gross margin percentages with industry averages or other entities of comparable size in the same industry.

.A3 Analytical procedures also include consideration of relationships, for example

- among elements of financial information, such as gross margin percentages, that would be expected to conform to a predictable pattern based on recent history of the entity and industry.
- between financial information and relevant nonfinancial information, such as payroll costs to number of employees.

.A4 Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components, and individual elements of information.

.A5 Scanning data is a type of analytical procedure involving the auditor's exercise of professional judgment to review accounting data to identify significant or unusual items to test. This type of analytical procedure is described further in section 500, *Audit Evidence*.[5] [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.A6 A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary. The reasons that make relationships plausible are an important consideration because data sometimes appears to be related when it is not, which may lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship may provide important evidence when appropriately scrutinized.

Substantive Analytical Procedures (Ref: par. .05)

.A7 The auditor's substantive procedures to address the assessed risk of material misstatement for relevant assertions may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's professional judgment about the expected effectiveness and efficiency of the available audit procedures to reduce the assessed risk of material misstatement to an acceptably low level.

.A8 The expected effectiveness and efficiency of a substantive analytical procedure in addressing risks of material misstatement depends on, among other things, (*a*) the nature of the assertion, (*b*) the plausibility and predictability of the relationship, (*c*) the availability and reliability of the data used to develop the expectation, and (*d*) the precision of the expectation.

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[5]Paragraph .A61 of section 500, *Audit Evidence*. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.A9 The auditor may inquire of management about the availability and reliability of information needed to apply substantive analytical procedures and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided that the auditor is satisfied that such data is properly prepared.

Suitability of Particular Substantive Analytical Procedures for Given Assertions (Ref: par. .05a)

.A10 When more persuasive audit evidence is desired from substantive analytical procedures, more predictable relationships are necessary to develop the expectation. Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts because income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion may be less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.

.A11 Substantive analytical procedures are generally more effective for large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, random fluctuations, or misstatements. The suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

.A12 In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, when an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognized trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

.A13 Different types of analytical procedures provide different levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments, and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided that the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence but may provide useful corroboration if used in combination with other audit procedures.

.A14 The determination of the suitability of particular substantive analytical procedures is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over payroll processing are deficient, the auditor may need to perform more extensive tests of details for assertions related to compensation.

.A15 Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts, in addition to performing tests of details on subsequent cash receipts, to determine the collectability of the receivables.

Considerations Specific to Governmental Entities

.A16 The relationships between individual financial statement items traditionally considered in the audit of for-profit businesses may not always be relevant in the audit of governmental entities. For example, relationships describing profitability or return on investment may have limited or no applicability. In addition, the nature of balances reported by a governmental entity may result in different expected relationships than those traditionally assumed for businesses. For example, relationships between revenue, receivables, and inventory may be different when revenue and receivables arise from nonexchange transactions and inventory does not represent products held for sale. Also, governmental entities' budgets are a source of data that may be used as a benchmark for evaluating individual financial statements.

The Reliability of the Data (Ref: par. .05b)

.A17 The reliability of data depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

a. The source of the information available. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias.[6]

b. The comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.

c. The nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.

[6]Paragraph .A22 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

d. Controls over the preparation of the information that are designed to ensure its completeness, accuracy, and validity. For example, controls over the preparation, review, and maintenance of budgets.

[Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.A18 Data may be readily available to develop expectations for some assertions. For example, the auditor may consider whether financial information, such as budgets or forecasts, and nonfinancial information, such as the number of units produced or sold, is available to design substantive analytical procedures.

.A19 The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor may have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over nonfinancial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. Section 330 addresses determining the audit procedures to be performed on the information to be used for substantive analytical procedures.[7]

.A20 The matters discussed in paragraph .A17*a–d* are relevant irrespective of whether the auditor performs substantive analytical procedures on the entity's period-end financial statements or at an interim date and plans to perform substantive analytical procedures for the remaining period. Section 330 addresses performing substantive procedures at an interim date.[8]

*Evaluation of Whether the Expectation Is Sufficiently Precise (Ref: **par. .05c**)*

.A21 In evaluating whether the expectation is sufficiently precise when performing a substantive analytical procedure, it is appropriate for the auditor to take into account whether substantive analytical procedures are the only substantive procedures planned to address a particular risk of misstatement at the relevant assertion level or whether the risk will be addressed through a combination of substantive analytical procedures and tests of details. A less precise expectation may be appropriate when evidence obtained from performing the substantive analytical procedure will be combined with audit evidence from performing tests of details. A more precise expectation, however, is necessary when the substantive analytical procedure is the only procedure planned to address a particular risk of misstatement for a relevant assertion.

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[7]Paragraph .25 of section 330.

[8]Paragraphs .23–.24 of section 330.

.A22 As expectations become more precise, the range of expected differences becomes narrower, and accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. Matters relevant to the auditor's evaluation of whether the expectation can be developed with sufficient precision to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include the following:

- The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
- The degree to which information can be disaggregated. For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity than when applied to the financial statements of the entity as a whole.

.A23 When expectations are developed at a more detailed level, it is more likely that the analytical procedure will more effectively address the assessed risk of misstatement to which it is directed. Monthly amounts may be more effective than annual amounts, and comparisons by location or line of business usually are more effective than companywide comparisons. The appropriate level of detail may be influenced by the nature of the entity, its size, and its complexity. The risk that material misstatements may be obscured by offsetting factors increases as an entity's operations become more complex and diversified. Disaggregation of the information helps reduce this risk.

Amount of Acceptable Difference of Recorded Amounts From Expected Values (Ref: par. .05d)

.A24 The auditor's determination of the amount of difference from the expectation that can be accepted without further investigation is influenced by materiality[9] and the desired level of assurance, while taking into account the possibility that a misstatement, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.[10] Accordingly, as the assessed risk increases, the amount of difference considered acceptable without further investigation decreases in order to achieve the desired level of persuasive evidence.[11]

Analytical Procedures That Assist When Forming an Overall Conclusion (Ref: par. .06)

.A25 A wide variety of analytical procedures may be used when forming an overall conclusion. These procedures may include reading the financial statements and considering

[9]Paragraph .A16 of section 320, *Materiality in Planning and Performing an Audit*.

[10]Paragraph .07*b* of section 330.

[11]Paragraph .A20 of section 330.

(*a*) the adequacy of the evidence gathered in response to unusual or unexpected balances identified during the course of the audit and (*b*) unusual or unexpected balances or relationships that were not previously identified. Results of these analytical procedures may indicate that additional evidence is needed.

.A26 The results of analytical procedures designed and performed in accordance with paragraph .06 may identify a previously unrecognized risk of material misstatement. In such circumstances, section 315A requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.[12]

.A27 The analytical procedures performed in accordance with paragraph .06 may be similar to those that would be used as risk assessment procedures.

Investigating Results of Analytical Procedures (Ref: par. .07)

.A28 Audit evidence relevant to management's responses may be obtained by evaluating those responses, taking into account the auditor's understanding of the entity and its environment and other audit evidence obtained during the course of the audit.

.A29 The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Documentation (Ref: par. .08)

.A30 Section 230, *Audit Documentation*, addresses the auditor's responsibilities for preparing audit documentation and applies to substantive analytical procedures and analytical procedures performed near the end of the audit. Paragraph .08 of this section addresses specific requirements that apply to substantive analytical procedures but is not intended to provide a complete list of items that are required to be documented by section 230.

[12]Paragraph .32 of section 315A.

AU-C Section 530

Audit Sampling

Source: SAS No. 122; SAS No. 142; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when the auditor has decided to use audit sampling in performing audit procedures. It addresses the auditor's use of statistical and nonstatistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample. (Ref: par. .A1–.A2)

.02 This section complements section 500, *Audit Evidence*, which explains what constitutes audit evidence and addresses how an auditor evaluates information to be used as audit evidence. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance on the means available to the auditor for selecting items for testing, one of which is audit sampling.[1] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Effective Date

.03 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.04 The objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Definitions

.05 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Audit sampling (sampling). The selection and evaluation of less than 100 percent of the population of audit relevance such that the auditor expects the items selected (the sample)

[1] Paragraphs .A65–.A71 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

to be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population. In this context, *representative* means that evaluation of the sample will result in conclusions that, subject to the limitations of sampling risk, are similar to those that would be drawn if the same procedures were applied to the entire population. (Ref: par. .A3)

Nonsampling risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. (Ref: par. .A4)

Population. The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Sampling risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

a. In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when, in fact, it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

b. In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when, in fact, it does not. This type of erroneous conclusion affects audit efficiency because it would usually lead to additional work to establish that initial conclusions were incorrect.

Sampling unit. The individual items constituting a population. (Ref: par. .A5)

Statistical sampling. An approach to sampling that has the following characteristics:

a. Random selection of the sample items (Ref: par. .A16)

b. The use of an appropriate statistical technique to evaluate sample results, including measurement of sampling risk

A sampling approach that does not have characteristics *a* and *b* is considered nonstatistical sampling.

Stratification. The process of dividing a population into subpopulations, each of which is a group of sampling units that have similar characteristics.

Tolerable misstatement. A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population. (Ref: par. .A6)

Tolerable rate of deviation. A rate of deviation set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Requirements

Sample Design, Size, and Selection of Items for Testing

.06 When designing an audit sample, the auditor should consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: par. .A7–.A11)

.07 The auditor should determine a sample size sufficient to reduce sampling risk to an acceptably low level. (Ref: par. .A12–.A14)

.08 The auditor should select items for the sample in such a way that the auditor can reasonably expect the sample to be representative of the relevant population and likely to provide the auditor with a reasonable basis for conclusions about the population. (Ref: par. .A15–.A17)

Performing Audit Procedures

.09 The auditor should perform audit procedures, appropriate to the purpose, on each item selected.

.10 If the audit procedure is not applicable to the selected item, the auditor should perform the procedure on a replacement item. (Ref: par. .A18)

.11 If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor should treat that item as a deviation from the prescribed control (in the case of tests of controls) or a misstatement (in the case of tests of details). (Ref: par. .A19–.A20)

Nature and Cause of Deviations and Misstatements

.12 The auditor should investigate the nature and cause of any deviations or misstatements identified and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit. (Ref: par. .A21–.A23)

Projecting the Results of Audit Sampling

.13 The auditor should project the results of audit sampling to the population. (Ref: par. .A24–.A25)

Evaluating the Results of Audit Sampling

.14 The auditor should evaluate

a. the results of the sample, including sampling risk, and (Ref: par. .A26–.A27)

b. whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: par. .A28)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The AICPA Audit Guide *Audit Sampling* provides interpretative guidance to apply the concepts in this section, including its definitions.

Considerations Specific to Governmental Entities

.A2 Chapter 11 of the AICPA Audit Guide Government Auditing Standards *and Circular A-133 Audits* provides interpretative guidance in designing an audit approach that includes audit sampling to achieve audit objectives related to both compliance and internal control over compliance in a Circular A-133 compliance audit or program-specific audit performed in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

Definitions

Audit Sampling (Ref: par. .05)

.A3 There may be audit procedures that are not considered audit sampling but that involve examination of fewer than 100 percent of the items comprising an account balance or class of transactions. For example, an auditor may examine only a few transactions from an account balance or class of transactions to (*a*) gain an understanding of the nature of an entity's operations or (*b*) clarify the auditor's understanding of the entity's internal control. In such cases, the guidance in this section is not applicable.

Nonsampling Risk (Ref: par. .05)

.A4 Examples of nonsampling risk include the use of inappropriate audit procedures or misinterpretation of audit evidence and failure to recognize a misstatement or deviation. Nonsampling risk may be reduced to an acceptable level through such factors as adequate planning (see section 300, *Planning an Audit*) and proper conduct of a firm's audit practice (see section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*).

Sampling Unit (Ref: par. .05)

.A5 The sampling units might be physical items (for example, checks listed on deposit slips, credit entries on bank statements, sales invoices, or accounts receivable) or monetary units.

Tolerable Misstatement (Ref: par. .05)

.A6 The auditor is required by section 320, *Materiality in Planning and Performing an Audit*, to determine performance materiality.[2] Performance materiality is determined to reduce to an appropriately low level the probability that the aggregate of uncorrected and

[2]Paragraph .11 of section 320, *Materiality in Planning and Performing an Audit*.

undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. *Tolerable misstatement* is the application of performance materiality to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount smaller than performance materiality (for example, when the population from which the sample is selected is smaller than the account balance).

Sample Design, Size, and Selection of Items for Testing

Sample Design (Ref: par. .06)

.A7 Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either statistical or nonstatistical sampling approaches.

.A8 When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. In fulfilling the requirement in section 500 when performing audit sampling, the auditor is required to perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.[3]

.A9 The auditor's consideration of the purpose of the audit procedure, as required by paragraph .06, includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the assertions are included in the evaluation of deviations or projection of misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client are not considered a misstatement. Also, an incorrect posting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this a misstatement in relation to the relevant assertion even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

.A10 In considering the test objective and characteristics of a population for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the controls. This assessment is made in order to design an audit sample and determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100 percent examination or increasing the sample size may be appropriate when performing tests of details. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[3]Paragraph .08 of section 500, *Audit Evidence*.

.A11 In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

Sample Size (Ref: par. .07)

.A12 The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size necessary.

.A13 The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment. Various factors typically influence determination of sample size, as follows:

- For tests of controls:
  - — The tolerable rate of deviation of the population to be tested
  - — The expected rate of deviation of the population to be tested
  - — The desired level of assurance (complement of risk of overreliance) that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population; the auditor may decide the desired level of assurance based on the extent to which the auditor's risk assessment takes into account relevant controls
  - — The number of sampling units in the population if the population is very small
- For substantive tests of details:
  - — The auditor's desired level of assurance (complement of risk of incorrect acceptance) that tolerable misstatement is not exceeded by actual misstatement in the population; the auditor may decide the desired level of assurance based on the following:
    - The auditor's assessment of the risk of material misstatement
    - The assurance obtained from other substantive procedures directed at the same assertion
  - — Tolerable misstatement
  - — Expected misstatement for the population
  - — Stratification of the population when performed
  - — For some sampling methods, the number of sampling units in each stratum

.A14 The decision whether to use a statistical or nonstatistical sampling approach is a matter for the auditor's professional judgment; however, sample size is not a valid criterion to use in deciding between statistical and nonstatistical approaches. An auditor who applies statistical sampling may use tables or formulas to compute sample size based on the factors in paragraph .A13. An auditor who applies nonstatistical sampling exercises professional judgment to relate the same factors used in statistical sampling in determining the appropriate sample size. Ordinarily, this would result in a sample size comparable with the sample size resulting from an efficient and effectively designed statistical sample, considering the same sampling parameters. This guidance does not suggest that the auditor using nonstatistical sampling also compute a corresponding sample size using an appropriate statistical technique.

Selection of Items for Testing (Ref: par. .08)

.A15 Audit sampling involves selection techniques that are probabilistic in nature. For example, through the assessment of the risk of material misstatement, an auditor might identify areas in which misstatement is relatively likely. The auditor might first separately examine those items deemed to be of relatively high risk and then use audit sampling (which will involve some form of probabilistic selection) to form an estimate of some characteristic of the remaining population.

.A16 Random selection techniques include the following:

a. Simple random

b. Systematic random

c. Probability weighted, including monetary unit

A detailed discussion of selection techniques is included in the AICPA Audit Guide *Audit Sampling*.

.A17 With statistical sampling, sample items are selected using random selection techniques. The principal techniques of selecting a nonstatistical sample are the use of random selection and haphazard selection to select sample items.

Performing Audit Procedures (Ref: par. .10–.11)

.A18 An example of when it is necessary to perform the procedure on a replacement item is when a voided check is selected while testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly voided such that it does not constitute a deviation, an appropriately chosen replacement is examined.

.A19 In some circumstances, the auditor may not be able to apply the planned audit procedures to selected sample items because, for example, the entity might not be able to locate supporting documentation. The auditor's treatment of unexamined items will depend on their effect on the auditor's evaluation of the sample. If the auditor's evaluation of the sample results would not be altered by considering those unexamined items to be misstated, it may not be necessary to examine the items, for example, if the aggregate amount of the unexamined items, if treated as misstatements or deviations, would not cause the auditor's assessment of the amount of the misstatement or deviation in the population to exceed tolerable misstatement or tolerable deviation, respectively. However, when this is not the case, the auditor is required by paragraph .11 to perform alternative procedures that provide sufficient appropriate audit evidence to form a conclusion about the sample item and use the results of these procedures in assessing the sample results. If alternative procedures cannot be satisfactorily performed in these cases, the auditor is required to treat the items as misstatements or deviations, as appropriate, in evaluating the results of the sample. Section 240, *Consideration of Fraud in a Financial Statement Audit*, also requires the auditor to consider whether the reasons for the auditor's inability to examine the items have implications with regard to assessing risks of material misstatement due to fraud, the assessed level of control risk that the auditor expects to be supported, or the degree of reliance on management representations.

.A20 An example of a suitable alternative procedure for an accounts receivable positive confirmation request for which no reply has been received might be the examination of subsequent cash receipts, together with evidence of their source and the items they are intended to settle.

Nature and Cause of Deviations and Misstatements (Ref: par. .12)

.A21 Section 450, *Evaluation of Misstatements Identified During the Audit*, explains that the auditor may request management to examine a class of transactions, account balance, or disclosure in order for management to understand the cause of a misstatement identified by the auditor; perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance, or disclosure; and make appropriate adjustments to the financial statements.[4]

.A22 In analyzing the deviations and misstatements identified, the auditor may observe that many have a common feature (for example, type of transaction, location, product line, or period of time). In such circumstances, the auditor may decide to identify all items in the population that possess the common feature and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional and may indicate the possibility of fraud.

.A23 In addition to the evaluation of the frequency and amounts of monetary misstatements, section 450 requires the auditor to consider the qualitative aspects of the misstatements.[5] These include (*a*) the nature and cause of misstatements, such as whether they are differences in principle or application, are errors, or are caused by fraud or are due to misunderstanding of instructions or carelessness, and (*b*) the possible relationship of the misstatements to other phases of the audit. The discovery of fraud requires a broader consideration of possible implications than does the discovery of an error.

Projecting the Results of Audit Sampling (Ref: par. .13)

.A24 For tests of details, the auditor is required by paragraph .13 to project misstatements observed in an audit sample to the population in order to obtain a likely misstatement. Due to sampling risk, this projection may not be sufficient to determine an amount to be recorded.

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[4]Paragraph .A9 of section 450, *Evaluation of Misstatements Identified During the Audit*.

[5]Paragraph .11 of section 450.

.A25 For tests of controls, the sample deviation rate is also the projected deviation rate for the population as a whole. Section 330 addresses the auditor's response when deviations from controls upon which the auditor intends to rely are detected.[6]

Evaluating the Results of Audit Sampling (Ref: par. .14)

.A26 For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risks of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.

.A27 Considering the results of other audit procedures helps the auditor assess the risk that actual misstatement in the population exceeds tolerable misstatement; such risk may be reduced if additional audit evidence is obtained. In the case of tests of details, the *projected misstatement* is the auditor's best estimate of misstatement in the population. As the projected misstatement approaches or exceeds tolerable misstatement, the more likely that actual misstatement in the population exceeds tolerable misstatement. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement. The AICPA Audit Guide *Audit Sampling* contains further guidance regarding the concept of sampling risk.

.A28 If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may

- request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments or
- tailor the nature, timing, and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control, or modify related substantive procedures.

Section 450 addresses misstatements identified by the auditor during the audit.

[6] Paragraph .17 of section 330.

AU-C Section 540

Auditing Accounting Estimates and Related Disclosures

(Supersedes SAS No. 122 section 540)

Source: SAS No. 143; SAS No. 144; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2023.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. Specifically, it includes requirements and guidance that refer to or expand on how section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 450, *Evaluation of Misstatements Identified During the Audit*; and section 500, *Audit Evidence*, and other relevant AU-C sections are to be applied with regard to accounting estimates and related disclosures. It also includes requirements and guidance related to the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Nature of Accounting Estimates

.02 Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgment by management and can give rise to complexity in measurement. The effects of complexity, subjectivity, or other inherent risk factors on the measurement of these monetary amounts affects their susceptibility to misstatement. (Ref: par. .A1–.A6 and app. A)

.03 Although this section applies to all accounting estimates, including fair value accounting estimates,[1] the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially. The nature, timing, and extent of the risk assessment and further audit procedures required by this section will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates, estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this section would not be expected to be extensive. When estimation uncertainty, complexity, or subjectivity are very high, such procedures would be expected to be much more extensive. This section contains guidance on how the requirements of this section can be scaled. (Ref: par. .A7)

Key Concepts of This Section

.04 Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires inherent risk and control risk to be assessed separately for identified risks of material misstatement at the relevant assertion level. In the context of this section and depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, and the interrelationship among them. As explained in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,[2] inherent risk is influenced by inherent risk factors. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, and the level of inherent risk varies on a scale that is referred to as *the spectrum of inherent risk*. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not intend to test and rely on the operating effectiveness of controls, the auditor's assessment of control risk is such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: par. .A8–.A10, .A65–.A66, and app. A) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.05 This section refers to relevant requirements in SAS No. 145 and section 330 and provides related guidance to emphasize the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether

- there are controls required to be identified in accordance with SAS No. 145[3] for which the auditor is required to evaluate their design and determine whether they have been implemented.

[1]For purposes of generally accepted auditing standards, a fair value measurement is a form of accounting estimate.

[2]Paragraph .A42 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[3]See paragraphs 27 and 29*b* of Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

- to test the operating effectiveness of relevant controls.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.06 This section emphasizes that the auditor's further audit procedures (including, when appropriate, tests of controls) need to be responsive to the reasons for the assessed risks of material misstatement at the relevant assertion level, taking into account the effect of one or more inherent risk factors and the auditor's assessment of control risk.

.07 The exercise of professional skepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity, or other inherent risk factors. Similarly, the exercise of professional skepticism is important when there is greater susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. (Ref: par. .A11) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.08 This section requires the auditor to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable[4] in the context of the applicable financial reporting framework or are misstated. For purposes of this section, *reasonable*, in the context of the applicable financial reporting framework, means that the relevant requirements of the applicable financial reporting framework have been applied appropriately, including those that address the following: (Ref: par. .A12–.A13 and .A139–.A144)

- The development of the accounting estimate, including the selection of the method, assumptions, and data in view of the nature of the accounting estimate and the facts and circumstances of the entity
- The selection of management's point estimate
- The disclosures about the accounting estimate, including disclosures about how the accounting estimate was developed and that explain the nature, extent, and sources of estimation uncertainty

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2023.

[4]See also paragraph .15*c* of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraph .40*c* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Objective

.10 The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable, in the context of the applicable financial reporting framework.

Definitions

.11 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

Accounting estimate. A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty. (Ref: par. .A14)

Auditor's point estimate or auditor's range. An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate. (Ref: par. .A15)

Estimation uncertainty. Susceptibility to an inherent lack of precision in measurement. (Ref: par. .A16 and app. A)

Management bias. A lack of neutrality by management in the preparation of information. (Ref: par. .A17)

Management's point estimate. The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

Outcome of an accounting estimate. The actual monetary amount that results from the resolution of the transactions, events, or conditions addressed by an accounting estimate. (Ref: par. .A18)

Requirements

Risk Assessment Procedures and Related Activities

.12 When obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control, as required by SAS No. 145, the auditor should obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding should be performed to the extent necessary to obtain audit evidence that provides an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.[5] (Ref: par. .A19–.A23)

[5]Paragraphs .05–.06 and .12–.13 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework

a. The entity's transactions or other events and conditions that may give rise to the need for or changes in accounting estimates to be recognized or disclosed in the financial statements (Ref: par. .A24)

b. The requirements of the applicable financial reporting framework related to accounting estimates (including the recognition criteria, measurement bases, and the related presentation and disclosure requirements) and how they apply in the context of the nature and circumstances of the entity and its environment, including how the inherent risk factors affect susceptibility of assertions to misstatement. (Ref: par. .A25–.A26)

c. Regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks (Ref: par. .A27)

d. The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements, based on the auditor's understanding of the matters in paragraph .12*a–c* of this section (Ref: par. .A28)

Obtaining an Understanding of the Entity's System of Internal Control

e. The nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to accounting estimates (Ref: par. .A29–.A31)

f. How management identifies the need for and applies specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's specialist (Ref: par. .A32)

g. How the entity's risk assessment process identifies and addresses risks relating to accounting estimates (Ref: par. .A33–.A34)

h. The entity's information system as it relates to accounting estimates, including the following:

   i. How information relating to accounting estimates and related disclosures for significant classes of transactions, account balances, or disclosures flows through the entity's information system (Ref: par. .A20 and .A35)

   ii. For such accounting estimates and related disclosures, how management

      1. identifies the relevant methods, assumptions, or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management (Ref: par. .A36–.A37)

         a. selects or designs, and applies, the methods used, including the use of models (Ref: par. .A38–.A39)

b. selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions (Ref: par. .A40–.A43)

c. selects the data to be used (Ref: par. .A44)

2. understands the degree of estimation uncertainty, including by considering the range of possible measurement outcomes (Ref: par. .A45)

3. addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements (Ref: par. .A46–.A49)

i. Identified controls in the control activities component[6] over management's process for making accounting estimates as described in paragraph .12*h*(ii) of this section (Ref: par. .A50–.A54)

j. How management reviews the outcomes of previous accounting estimates and responds to the results of that review

.13 The auditor should review the outcome of previous accounting estimates or, when applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period. The auditor should take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgments about previous-period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: par. .A55–.A60)

.14 With respect to accounting estimates, the auditor should determine whether the engagement team requires specialized skills or knowledge to perform the risk assessment procedures, to identify and assess the risks of material misstatement, to design and perform audit procedures to respond to those risks, or to evaluate the audit evidence obtained. (Ref: par. .A61–.A63)

Identifying and Assessing the Risks of Material Misstatement

.15 In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, including separately assessing inherent risk and control risk, as required by SAS No. 145,[7] the auditor should take the following into account in identifying the risks of material misstatement and assessing inherent risk: (Ref: par. .A64–.A71)

[6] Paragraphs 27 and 29*b* of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[7] Paragraphs 31–34 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

a. The degree to which the accounting estimate is subject to estimation uncertainty (Ref: par. .A72–.A75)

b. The degree to which one or both of the following are affected by complexity, subjectivity, or other inherent risk factors: (Ref: par. .A76–.A79)

   i. The selection and application of the method, assumptions, and data in making the accounting estimate

   ii. The selection of management's point estimate and related disclosures for inclusion in the financial statements

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.16 The auditor should determine whether any of the risks of material misstatement identified and assessed in accordance with paragraph .15 are, in the auditor's professional judgment, a significant risk.[8] If the auditor has determined that a significant risk exists, the auditor should identify controls that address that risk[9] and evaluate whether such controls have been suitably designed and implemented to mitigate such risks.[10] (Ref: par. .A80) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Responses to the Assessed Risks of Material Misstatement

.17 As required by section 330,[11] the auditor's further audit procedures should be responsive to the assessed risks of material misstatement at the relevant assertion level,[12] considering the reasons for the assessment given to those risks. The auditor's further audit procedures should include one or more of the following approaches:

a. Obtaining audit evidence from events occurring up to the date of the auditor's report (see paragraph .20 of this section)

b. Testing how management made the accounting estimate (see paragraphs .21–.26 of this section)

c. Developing an auditor's point estimate or range (see paragraphs .27–.28 of this section)

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[8]Paragraph 32 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[9]Paragraph 26*a*(i) of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[10]Paragraph 26*a* of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[11]Paragraphs .06–.15 and .18 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[12]Paragraphs .06–.07 and .22 of section 330. [Footnote renumbered, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

The auditor's further audit procedures should take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be.[13] The auditor should design and perform further audit procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory. (Ref: par. .A81–.A84)

.18 As required by section 330,[14] the auditor should design and perform tests to obtain sufficient appropriate audit evidence about the operating effectiveness of controls, if

a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively, or

b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level.

In relation to accounting estimates, the auditor's tests of such controls should be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.[15] (Ref: par. .A85–.A89) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.19 For a significant risk relating to an accounting estimate, the auditor's further audit procedures should include tests of controls in the current period if the auditor plans to rely on those controls. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details.[16] (Ref: par. .A90)

Obtaining Audit Evidence From Events Occurring Up to the Date of the Auditor's Report

.20 When the auditor's further audit procedures include obtaining audit evidence from events occurring up to the date of the auditor's report, the auditor should evaluate whether such audit evidence is sufficient and appropriate to address the risks of material misstatement relating to the accounting estimate, taking into account that changes in circumstances and other relevant conditions between the event and the measurement date may affect the relevance of such audit evidence in the context of the applicable financial reporting framework. (Ref: par. .A91–.A93)

Testing How Management Made the Accounting Estimate

.21 When testing how management made the accounting estimate, the auditor's further audit procedures should include procedures, designed and performed in accordance with paragraphs .22–.25, to obtain sufficient appropriate audit evidence regarding the risks of material misstatement[17] relating to the following: (Ref: par. .A94)

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[13]Paragraph .07*b* of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[14]Paragraph .08 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[15]Paragraph .09 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[16]Paragraphs .15 and .22 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

a. The selection and application of the methods, significant assumptions, and data used by management in making the accounting estimate

b. How management selected the point estimate and developed related disclosures about estimation uncertainty

Methods

.22 In applying the requirements of paragraph .21, with respect to methods, the auditor's further audit procedures should address the following:

a. Whether the method selected is appropriate in the context of the applicable financial reporting framework and, if applicable, changes from the method used in prior periods are appropriate (Ref: par. .A95 and .A97)

b. Whether judgments made in selecting the method give rise to indicators of possible management bias (Ref: par. .A96)

c. Whether the calculations are applied in accordance with the method and are mathematically accurate

d. When management's application of the method involves complex modeling, whether judgments have been applied consistently, and whether, when applicable (Ref: par. .A98–.A100)

   i. the design of the model meets the measurement objective of the applicable financial reporting framework, is appropriate in the circumstances, and, if applicable, changes from the prior period's model are appropriate in the circumstances.

   ii. adjustments to the output of the model are consistent with the measurement objective of the applicable financial reporting framework and are appropriate in the circumstances.

e. Whether the integrity of the significant assumptions and the data has been maintained in applying the method (Ref: par. .A101)

Significant Assumptions

.23 In applying the requirements of paragraph .21, with respect to significant assumptions, the auditor's further audit procedures should address the following:

a. Whether the significant assumptions are appropriate in the context of the applicable financial reporting framework and, if applicable, changes from prior periods are appropriate (Ref: par. .A95 and .A102–.A103)

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[17]See paragraph .17 of this section for discussion regarding the responses to the assessed risk of material misstatement. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

b. Whether judgments made in selecting the significant assumptions give rise to indicators of possible management bias (Ref: par. .A96)

c. Whether the significant assumptions are consistent with each other and with those used in other accounting estimates, or with related assumptions used in other areas of the entity's business activities, based on the auditor's knowledge obtained in the audit (Ref: par. .A104)

d. When applicable, whether management has the intent to carry out specific courses of action and has the ability to do so (Ref: par. .A105)

Data

.24 In applying the requirements of paragraph .21, with respect to data, the auditor's further audit procedures should address the following:

a. Whether the data is appropriate in the context of the applicable financial reporting framework and, if applicable, changes from prior periods are appropriate (Ref: par. .A95 and .A106)

b. Whether judgments made in selecting the data give rise to indicators of possible management bias (Ref: par. .A96)

c. Whether the data is relevant and reliable in the circumstances (Ref: par. .A107)

d. Whether the data has been appropriately understood or interpreted by management, including with respect to contractual terms (Ref: par. .A108)

Management's Selection of a Point Estimate and Related Disclosures About Estimation Uncertainty

.25 In applying the requirements of paragraph .21, the auditor's further audit procedures should address whether, in the context of the applicable financial reporting framework, management has taken appropriate steps to do the following:

a. Understand estimation uncertainty (Ref: par. .A109)

b. Address estimation uncertainty by selecting an appropriate point estimate and by developing related disclosures about estimation uncertainty (Ref: par. .A110–.A114)

.26 When, in the auditor's judgment based on the audit evidence obtained, management has not taken appropriate steps to understand or address estimation uncertainty, the auditor should (Ref: par. .A115–.A117)

a. request management to perform additional procedures to understand estimation uncertainty or address it by reconsidering the selection of management's point estimate or considering providing additional disclosures relating to the estimation uncertainty, and evaluate management's responses in accordance with paragraph .25 of this section.

b. to the extent practicable, develop an auditor's point estimate or range in accordance with paragraphs .27–.28 of this section, if the auditor determines that management's response to the auditor's request does not sufficiently address estimation uncertainty.

c. evaluate whether a deficiency in internal control exists and, if so, communicate in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit.*

Developing an Auditor's Point Estimate or Range

.27 When the auditor develops a point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty, including when required by paragraph .26*b*, the auditor's further audit procedures should include procedures to evaluate whether the methods, assumptions, or data used are appropriate in the context of the applicable financial reporting framework. Regardless of whether the auditor uses management's or the auditor's own methods, assumptions, or data, these further audit procedures should be designed and performed to address the matters in paragraphs .22–.24. (Ref: par. .A118–.A123)

.28 If the auditor develops an auditor's range, the auditor should

a. determine that the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework. (Ref: par. .A124–.A125)

b. design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement relating to the disclosures in the financial statements that describe the estimation uncertainty.

Other Considerations Relating to Audit Evidence

.29 In obtaining audit evidence regarding the risks of material misstatement relating to accounting estimates, irrespective of the sources of information to be used as audit evidence, the auditor should comply with the relevant requirements in section 500 and section 501, *Audit Evidence — Specific Considerations for Selected Items*.

.30 When using the work of a management's specialist, the requirements in paragraphs .20–.28 of this section may assist the auditor in evaluating the appropriateness of the specialist's work as audit evidence for a relevant assertion in accordance with section 501.[18] In evaluating the work of the management's specialist, the nature, timing, and extent of the further audit procedures are affected by the auditor's evaluation of the specialist's competence, capabilities, and objectivity; the auditor's understanding of the nature of the work performed by the specialist; and the auditor's familiarity with the specialist's field of expertise. (Ref: par. .A126–.A132)

[18] Paragraph .27*c* of section 501, *Audit Evidence — Specific Considerations for Selected Items*, as amended by Statement on Auditing Standards (SAS) No. 142, *Audit Evidence* (sec. 500). [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Disclosures Related to Accounting Estimates

.31 The auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level for disclosures related to an accounting estimate, including those procedures related to estimation uncertainty addressed in paragraphs .25*b* and .28*b*.

Indicators of Possible Management Bias

.32 The auditor should evaluate whether judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias. When indicators of possible management bias are identified, the auditor should evaluate the implications for the audit. When there is intention to mislead, management bias is fraudulent in nature. (Ref: par. .A133–.A136)

Overall Evaluation Based on Audit Procedures Performed

.33 In applying section 330 to accounting estimates,[19] the auditor should evaluate, based on the audit procedures performed and audit evidence obtained, whether (Ref: par. .A137–.A138)

a. the assessments of the risks of material misstatement at the relevant assertion level remain appropriate, including when indicators of possible management bias have been identified;

b. management's decisions relating to the recognition, measurement, presentation, and disclosure of these accounting estimates in the financial statements are in accordance with the applicable financial reporting framework; and

c. sufficient appropriate audit evidence has been obtained.

.34 In making the evaluation required by paragraph .33*c* of this section, the auditor should take into account all relevant audit evidence obtained, whether corroborative or contradictory.[20] If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Determining Whether the Accounting Estimates Are Reasonable or Misstated

.35 The auditor should determine whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated. Section 450[21] provides guidance on how the auditor may distinguish misstatements (whether factual, judgmental, or projected) for the auditor's evaluation of

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[19]Paragraphs .27–.28 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[20]Paragraph .28 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

the effect of uncorrected misstatements on the financial statements. (Ref: par. .A12–.A13 and .A139–.A145)

.36 In relation to accounting estimates, the auditor should evaluate whether management has included disclosures, beyond those specifically required by the framework, that are necessary to achieve the fair presentation of the financial statements as a whole.[22]

Communication With Those Charged With Governance, Management, or Other Relevant Parties

.37 In applying section 260, *The Auditor's Communication With Those Charged With Governance*,[23] and section 265,[24] the auditor is required to communicate with those charged with governance or management about certain matters, including significant qualitative aspects of the entity's significant accounting practices and significant deficiencies and material weaknesses in internal control identified during the audit, respectively. In doing so, the auditor should consider the matters, if any, to communicate regarding accounting estimates and take into account whether the reasons given to the risks of material misstatement relate to estimation uncertainty or the effects of complexity, subjectivity, or other inherent risk factors in making accounting estimates and related disclosures. In addition, in certain circumstances, the auditor is required by law or regulation to communicate about certain matters with other relevant parties, such as regulators. (Ref: par. .A146–.A147)

Documentation

.38 The auditor should include the following in the audit documentation:[25] (Ref: par. .A148–.A151)

a. Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates

b. The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level,[26] taking into account the reasons given to the assessment of those risks

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[21] Paragraph .A3 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[22] See also paragraphs .16 and .A16 of section 700 or paragraphs .41 and .A71 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[23] Paragraph .12*a* of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[24] Paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[25] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[26] Paragraph .30*b* of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

c. The auditor’s responses when management has not taken appropriate steps to understand and address estimation uncertainty

d. Indicators of possible management bias related to accounting estimates, if any, and the auditor’s evaluation of the implications for the audit, as required by paragraph .32

e. Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated

Application and Other Explanatory Material

Nature of Accounting Estimates

Examples of Accounting Estimates

.A1 Examples of accounting estimates related to classes of transactions, account balances, and disclosures include the following:

- Inventory obsolescence
- Depreciation of property and equipment
- Valuation of infrastructure assets, such as buildings and roadways
- Valuation of financial instruments
- Outcome of pending litigation
- Provision for expected credit losses
- Valuation of insurance contract liabilities
- Warranty obligations
- Employee retirement benefits liabilities
- Share-based payments
- Fair value of assets or liabilities acquired in a business combination, including the determination of goodwill and intangible assets
- Impairment of long-lived assets or property or equipment held for disposal
- Nonmonetary exchanges of assets or liabilities between independent parties
- Revenue recognized for long-term contracts

Methods

.A2 A *method* is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black-Scholes option-pricing formula. A method is applied using a computational tool or process, sometimes referred to as a *model*, and involves applying assumptions and data and taking into account a set of relationships between them.

Assumptions and Data

.A3 Assumptions involve judgments based on available information about matters such as the choice of an interest rate, a discount rate, or judgments about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

.A4 For purposes of this section, *data* is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as *derived data* when such techniques have a well-established theoretical basis and, therefore, less need for management judgment. Otherwise, such information is an assumption.

.A5 Examples of data include one or more of the following:

- Prices generated by market transactions
- Operating times or quantities of output from a production machine
- Historical prices or other terms included in contracts, such as a contracted interest rate, a payment schedule, and term included in a loan agreement
- Forward-looking information, such as economic or earnings forecasts obtained from an external information source
- A future interest rate determined using interpolation techniques from forward interest rates (derived data)

.A6 Data can come from a wide range of sources. For example, data can be

- generated within the organization or externally,
- obtained from a system that is either within or outside the general or subsidiary ledgers,
- observable in contracts, or
- observable in legislative or regulatory pronouncements.

Scalability (Ref: par. .03)

.A7 Examples of paragraphs that include guidance on how the requirements of this section can be scaled include paragraphs .A21–.A23, .A64, .A68, and .A85.

Key Concepts of This Section

Inherent Risk Factors (Ref: par. .04)

.A8 *Inherent risk factors* are characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls.[27]Appendix A, "Inherent Risk Factors," further explains the nature of these inherent risk factors, and their interrelationships, in the context of making accounting estimates and their presentation in the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A9 When assessing the risks of material misstatement at the assertion level[28] in addition to estimation uncertainty, complexity, and subjectivity, the auditor also takes into account the degree to which other inherent risk factors included in SAS No. 145 affect susceptibility of assertions to misstatement about the accounting estimate. Such additional inherent risk factors include the following:

- A change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework, which may give rise to the need for changes in the method, assumptions, or data used to make the accounting estimate
- Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk, in making the accounting estimate
- Uncertainty, other than estimation uncertainty

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Control Risk

.A10 In assessing control risk at the relevant assertion level in accordance with SAS No. 145, the auditor takes into account whether the auditor plans to test the operating effectiveness of controls. When the auditor is considering whether to test the operating effectiveness of controls, the auditor's evaluation that controls are effectively designed and have been implemented supports an expectation, by the auditor, about the operating effectiveness of the controls in establishing the plan to test them. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

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[27]Paragraph 12 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[28]Paragraph 31 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Professional Skepticism (Ref: par. .07)

.A11 Paragraphs .A60, .A95–.A96, .A137, and .A139 are examples of paragraphs that describe ways in which the auditor can exercise professional skepticism. Paragraph .A151 provides guidance on ways in which the auditor's exercise of professional skepticism may be documented and includes examples of specific paragraphs in this section for which documentation may provide evidence of the exercise of professional skepticism.

Concept of "Reasonable" (Ref: par. .08 and .35)

.A12 Other considerations that may be relevant to the auditor's consideration of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework include whether

- the data and assumptions used in making the accounting estimate are consistent with each other and with those used in other accounting estimates or areas of the entity's business activities, and
- the accounting estimate takes into account appropriate information as required by the applicable financial reporting framework.

.A13 The term *applied appropriately* as used in paragraph .08 means in a manner that not only complies with the requirements of the applicable financial reporting framework but, in doing so, reflects judgments that are consistent with the objective of the measurement basis in that framework.

Definitions

Accounting Estimate (Ref: par. .11)

.A14 *Accounting estimates* are monetary amounts that may be related to classes of transactions or account balances recognized or disclosed in the financial statements. Accounting estimates also include monetary amounts included in disclosures or used to make judgments about recognition or disclosure relating to a class of transactions or account balances. For purposes of GAAS, a fair value measurement is a form of accounting estimate.

Auditor's Point Estimate or Auditor's Range (Ref: par. .11)

.A15 An auditor's point estimate or range may be used to evaluate an accounting estimate directly (for example, an impairment provision or the fair value of different types of financial instruments) or indirectly (for example, an amount to be used as a significant assumption for an accounting estimate). A similar approach may be taken by the auditor in developing an amount or range of amounts in evaluating a nonmonetary item of data or an assumption (for example, an estimated useful life of an asset).

Estimation Uncertainty (Ref: par. .11)

.A16 Not all accounting estimates are subject to a high degree of estimation uncertainty. For example, some financial statement items may have an active and open market that provides readily available and reliable information on the prices at which actual exchanges occur. Estimation uncertainty may exist even when the valuation method and data are well-defined. In addition, general economic circumstances prevailing at the time, for example, illiquidity in a particular market, may affect estimation uncertainty.

Management Bias (Ref: par. .11)

.A17 Financial reporting frameworks often call for neutrality, that is, freedom from bias. Estimation uncertainty gives rise to subjectivity in making an accounting estimate. The presence of subjectivity gives rise to the need for judgment by management and the susceptibility to unintentional or intentional management bias. The susceptibility of an accounting estimate to management bias increases with the extent to which there is subjectivity in making the accounting estimate

Outcome of an Accounting Estimate (Ref: par. .11)

.A18 Some accounting estimates, by their nature, do not have an outcome that is relevant for the auditor's work performed in accordance with this section. For example, an accounting estimate may be based on perceptions of market participants at a point in time. Accordingly, the price realized when an asset is sold or a liability is transferred may differ from the related accounting estimate made at the reporting date because, with the passage of time, the market participants' perceptions of value have changed.

Risk Assessment Procedures and Related Activities

Obtaining an Understanding of the Entity and Its Environment (Ref: par. .12)

.A19 SAS No. 145[29] requires the auditor to obtain an understanding of certain matters about the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. The requirements in paragraph .12 of this section relate more specifically to accounting estimates and build on the broader requirements in SAS No. 145. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A20 The classes of transactions, events, and conditions within the scope of paragraph .12*h* of this section are the same as the classes of transactions, events, and conditions relating to accounting estimates and related disclosures that are subject to SAS No. 145.[30] In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider

- whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from nonrecurring or unusual transactions.
- how the information system addresses the completeness of accounting estimates and related disclosures, in particular, for accounting estimates related to liabilities.

[29] Paragraphs .12–.25 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[30] Paragraph .19*a* and *d* of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Scalability

.A21 The nature, timing, and extent of the auditor's procedures to obtain the understanding of the entity and its environment, including the applicable financial reporting framework, and the entity's system of internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent to which the individual matters apply in the circumstances. For example, the entity may have few transactions or other events or conditions that give rise to the need for accounting estimates; the applicable financial reporting requirements may be simple to apply; and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer identified controls in the control activities component. If so, the auditor's risk assessment procedures are likely to be less extensive and may be performed primarily through inquiries of management with appropriate responsibilities for the financial statements, such as observation of management's process for making the accounting estimate (including when evaluating whether identified controls in that process are designed effectively and when determining whether the control has been implemented). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 By contrast, the accounting estimates may require significant judgments by management, and the process for making the accounting estimates may be complex and involve the use of complex models. In addition, the entity may have a more sophisticated information system and more extensive controls over accounting estimates. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, subjectivity, complexity, or other inherent risk factors to a greater degree. If so, the nature or timing of the auditor's risk assessment procedures are likely to be different, or more extensive, than in the circumstances in paragraph .A21.

.A23 The following considerations may be relevant for entities with only simple businesses, which may include many smaller entities: (Ref: par. .A72 and .A149)

- Processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.
- Accounting estimates may be generated outside of the general and subsidiary ledgers, controls over their development may be limited, and an owner-manager may have significant influence over their determination. The owner-manager's role in making the accounting estimates may need to be taken into account by the auditor both when identifying the risks of material misstatement and when considering the risk of management bias.

The Entity and Its Environment

.A24 *The entity's transactions and other events or conditions (Ref: par. .12*a*).* Changes in circumstances that may give rise to the need for or changes in accounting estimates may include, for example, whether

- the entity has engaged in new types of transactions,
- terms of transactions have changed, or
- new events or conditions have occurred.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A25 *The requirements of the applicable financial reporting framework (Ref: par. .12*b*).* Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, when applicable, those charged with governance about how management has applied the requirements of the applicable financial reporting framework relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework to not be the most appropriate in the circumstances of the entity.[31] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A26 In obtaining this understanding, the auditor may seek to understand whether

- the applicable financial reporting framework
  - — prescribes certain criteria for the recognition, or methods for the measurement of, accounting estimates,
  - — specifies certain criteria that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability, or
  - — specifies required or suggested disclosures, including disclosures concerning judgments, assumptions, or other sources of estimation uncertainty relating to accounting estimates, and
- changes in the applicable financial reporting framework require changes to the entity's accounting policies relating to accounting estimates.

.A27 *Regulatory factors (Ref: par. .12*c*).* Obtaining an understanding of regulatory factors, if any, that are relevant to accounting estimates may assist the auditor in identifying applicable regulatory frameworks and in determining whether such regulatory frameworks

[31] Paragraph .12*a* of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- address conditions for the recognition, or methods for the measurement, of accounting estimates or provides related guidance thereon,
- specify or provide guidance about disclosures in addition to the requirements of the applicable financial reporting framework,
- provide an indication of areas for which there may be a potential for management bias to meet regulatory requirements, or
- contain requirements for regulatory purposes that are not consistent with requirements of the applicable financial reporting framework, which may indicate potential risks of material misstatement. For example, some regulators may seek to influence minimum levels for expected credit loss provisions that exceed those required by the applicable financial reporting framework.

.A28 *The nature of the accounting estimates and related disclosures that the auditor expects to be included in the financial statements (Ref: par. .12*d*).* Obtaining an understanding of the nature of accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements assists the auditor in understanding the measurement basis of such accounting estimates and the nature and extent of disclosures that may be relevant. Such an understanding provides the auditor with a basis for discussion with management about how management makes the accounting estimates.

The Entity's System of Internal Control

.A29 *The nature and extent of oversight and governance (Ref: par. .12*e*).* In applying SAS No. 145,[32] the auditor's understanding of the nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates may be important to the auditor's required evaluation about whether

- management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior, and
- the control environment provides an appropriate foundation for the other components of the system of internal control considering the nature and size of the entity, and
- control deficiencies identified in the control environment undermine the other components of the system of internal control.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A30 The auditor may obtain an understanding of whether those charged with governance

- have the skills or knowledge to understand the characteristics of a particular method or model to make accounting estimates, or the risks related to the accounting estimate, for example, risks related to the method or IT used in making the accounting

[32]Paragraph 21*a* of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

estimates, or the susceptibility of the accounting estimate to misstatement due to management bias or fraud,

- have the skills and knowledge to understand whether management made the accounting estimates in accordance with the applicable financial reporting framework,
- have the information required to evaluate on a timely basis how management made the accounting estimates and the authority to call into question management's actions when those actions appear to be inadequate or inappropriate,
- oversee management's process for making the accounting estimates, including the use of models, or
- oversee the monitoring activities undertaken by management. This may include supervision and review procedures designed to detect and correct any deficiencies in the design or operating effectiveness of controls over the accounting estimates.

.A31 Obtaining an understanding of the oversight by those charged with governance may be important when there are accounting estimates that

- require significant judgment by management to address subjectivity,
- have high estimation uncertainty,
- are complex to make, for example, because of the extensive use of IT, large volumes of data, or the use of multiple data sources or assumptions with complex interrelationships,
- had or ought to have had a change in the method, assumptions, or data compared to previous periods, or
- involve significant assumptions.

.A32 *Management's application of specialized skills or knowledge, including the use of management's specialists (Ref: par. .12f).* The auditor may consider whether the following circumstances increase the likelihood that management needs to engage a specialist:[33]

- The specialized nature of the matter requiring estimation, for example, the accounting estimate may involve measurement of mineral or hydrocarbon reserves in extractive industries or the evaluation of the likely outcome of applying complex contractual terms
- The complex nature of the models required to apply the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements, such as level 3 fair values[34]

[33]See paragraph .27 of section 501 as amended by SAS No. 142. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[34]See, for example, FASB *Accounting Standards Codification* (ASC) 820, *Fair Value Measurement*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- The unusual or infrequent nature of the condition, transaction, or event requiring an accounting estimate

.A33 *The entity's risk assessment process (Ref: par. .12*g*).* Understanding how the entity's risk assessment process identifies and addresses risks relating to accounting estimates may assist the auditor in considering changes in the following:

- The requirements of the applicable financial reporting framework related to the accounting estimates
- The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used
- The entity's information system or IT environment
- Key personnel

.A34 Matters that the auditor may consider in obtaining an understanding of how management identifies and addresses the susceptibility to misstatement due to management bias or fraud in making accounting estimates, include whether, and if so, how, management does the following:

- Pays particular attention to selecting or applying the methods, assumptions, and data used in making accounting estimates
- Monitors key performance indicators that may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors
- Identifies financial or other incentives that may be a motivation for bias
- Monitors the need for changes in the methods, significant assumptions, or the data used in making accounting estimates
- Establishes appropriate oversight and review of models used in making accounting estimates
- Requires documentation of the rationale for or an independent review of significant judgments made in making accounting estimates

.A35 *The entity's information system relating to accounting estimates (Ref: par. .12*h*(i)).* During the audit, the auditor may identify classes of transactions, events, or conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. SAS No. 145 addresses circumstances in which the auditor identifies risks of material misstatement that management failed to identify, including considering the implications for the auditor's evaluation of the entity's risk assessment process.[35] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[35] Paragraph .18 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A36 *Management's identification of the relevant methods, assumptions, and sources of data (Ref: par. .12*h*(ii)(1)).* If management has changed the method for making an accounting estimate, considerations may include whether the new method is, for example, more appropriate; is itself a response to changes in the environment or circumstances affecting the entity or to changes in the requirements of the applicable financial reporting framework or regulatory environment; or whether management has another valid reason.

.A37 If management has not changed the method for making an accounting estimate, considerations may include whether the continued use of the previous methods, assumptions, and data is appropriate in view of the current environment or circumstances.

.A38 *Methods (Ref: par. .12*h*(ii)(1)(a)).* The applicable financial reporting framework may prescribe the method to be used in making an accounting estimate. In many cases, however, the applicable financial reporting framework does not prescribe a single method, or the required measurement basis prescribes, or allows, the use of alternative methods.

.A39 *Models.* Management may design and implement specific controls around models used for making accounting estimates, whether it's management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address the risks of material misstatement related to such complexity or subjectivity may be more likely to be identified in accordance with SAS No. 145.[36] When complexity in relation to models is present, controls over data integrity are also more likely to be identified controls in accordance with SAS No. 145. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and related identified controls include the following:

- How management determines the relevance and accuracy of the model.
  - — The validation or back-testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of
    - the model's theoretical soundness,
    - the model's mathematical integrity, and
    - the accuracy and completeness of the data and the appropriateness of data and assumptions used in the model.
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model.
- Whether adjustments, also referred to as *overlays* in certain industries, are made to the output of the model and whether such adjustments are appropriate in the circumstances in accordance with the requirements of the applicable financial

[36]Paragraph 27 and 29*b* of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

reporting framework. When the adjustments are not appropriate, such adjustments may be indicators of possible management bias.

- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, and the results of any validation performed on it and the nature of and basis for any adjustments made to its output.

Examples of valuation models may include the present value of expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A40 *Assumptions (Ref: par. .12*h*(ii)(1)(b)).* Matters that the auditor may consider in obtaining an understanding of how management selected the assumptions used in making the accounting estimates include, for example, the following:

- The basis for management's selection and the documentation supporting the selection of the assumption. The applicable financial reporting framework may provide criteria or guidance to be used in the selection of an assumption.
- How management assesses whether the assumptions are relevant and complete.
- When applicable, how management determines that the assumptions are consistent with each other, with those used in other accounting estimates or areas of the entity's business activities, or with other matters that are
  - — within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life) and whether they are consistent with the entity's business plans and the external environment, and
  - — outside the control of management (for example, assumptions about interest rates, mortality rates, or potential judicial or regulatory actions).
- The requirements of the applicable financial reporting framework related to the disclosure of assumptions.

.A41 With respect to fair value accounting estimates, assumptions vary in terms of the sources of the data and the basis for the judgments to support them, as follows:

a. Those that reflect what market participants would use in pricing an asset or liability, developed based on market data obtained from sources independent of the reporting entity

b. Those that reflect the entity's own judgments about what assumptions market participants would use in pricing the asset or liability, developed based on the best data available in the circumstances

In practice, however, the distinction between (*a*) and (*b*) may not always be apparent, and distinguishing between them depends on understanding the sources of data and the basis for the judgments that support the assumption. Further, it may be necessary for management to select from a number of different assumptions used by different market participants.

.A42 Assumptions used in making an accounting estimate are referred to as *significant assumptions* in this section if a reasonable variation in the assumption would materially affect the measurement of the accounting estimate. A sensitivity analysis may be useful in demonstrating the degree to which the measurement varies based on one or more assumptions used in making the accounting estimate.

.A43 *Inactive or illiquid markets.* When markets are inactive or illiquid, the auditor's understanding of how management selects assumptions may include understanding the following:

- Whether management has implemented appropriate policies for adapting the application of the method in such circumstances. Such adaptation may include making model adjustments or developing new models that are appropriate in the circumstances.
- Whether management has resources with the necessary skills or knowledge to adapt or develop a model, if necessary, on an urgent basis, including selecting the valuation technique that is appropriate in such circumstances.
- Whether management has the resources to determine the range of outcomes, given the uncertainties involved, for example, by performing a sensitivity analysis.
- Whether management has the means to assess how, when applicable, the deterioration in market conditions has affected the entity's operations, environment, and relevant business risks and the implications for the entity's accounting estimates, in such circumstances.
- Whether management has an appropriate understanding of how the price data, and the relevance thereof, from particular external information sources may vary in such circumstances.

.A44 *Data (Ref: par. .12*h*(ii)(1)(c)).* Matters that the auditor may consider in obtaining an understanding of how management selects the data on which the accounting estimates are based include the following:

- The nature and source of the data, including information obtained from an external information source
- How management evaluates whether the data is appropriate
- The accuracy and completeness of the data
- The consistency of the data used with data used in previous periods

- The complexity of the IT applications or other aspects of the entity's IT environment used to obtain and process the data, including when this involves handling large volumes of data
- How the data is obtained, transmitted, and processed and how its integrity is maintained

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A45 *How management understands and addresses estimation uncertainty (Ref: par. .12*h*(2)–(3)).* Matters that may be appropriate for the auditor to consider relating to whether and how management understands the degree of estimation uncertainty include, for example, the following:

- Whether, and if so, how, management identified alternative methods, significant assumptions, or sources of data that are appropriate in the context of the applicable financial reporting framework
- Whether, and if so, how, management considered alternative outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the significant assumptions or the data used in making the accounting estimate

.A46 The requirements of the applicable financial reporting framework may specify the approach to selecting management's point estimate from the reasonably possible measurement outcomes. Financial reporting frameworks may recognize that the appropriate amount is one that is appropriately selected from the reasonably possible measurement outcomes and, in some cases, may indicate that the most relevant amount may be in the central part of that range.

.A47 For example, with respect to fair value estimates, FASB *Accounting Standards Codification* (ASC) 820, *Fair Value Measurment*,[37] indicates that if multiple valuation techniques are used to measure fair value, the results (that is, respective indications of fair value) should be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances. In other cases, such as estimates for loss contingencies, FASB ASC 450, *Contingencies*,[38] indicates that when recognition criteria are met and the reasonably estimable loss is a range, if no amount in the range is a better estimate than any other amount, the minimum amount in the range is required to be accrued.

.A48 The applicable financial reporting framework may prescribe disclosures or disclosure objectives related to accounting estimates, and some entities may choose to disclose additional information. These disclosures or disclosure objectives may address, for example, the following:

[37]Paragraph 24B of FASB ASC 820-10-35. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]
[38]Paragraph 1 of FASB ASC 450-20-30. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- The method of estimation used, including any applicable model and the basis for its selection
- Information that has been obtained from models, or from other calculations used to determine estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as
  - — assumptions developed internally, or
  - — data, such as interest rates, that are affected by factors outside the control of the entity
- The effect of any changes to the method of estimation from the prior period
- The sources of estimation uncertainty
- Fair value information
- Information about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions

.A49 In some cases, the applicable financial reporting framework may require specific disclosures regarding estimation uncertainty. Examples follow:

- The disclosure of information about the assumptions made about the future and other major sources of estimation uncertainty that give rise to a higher likelihood or magnitude of material adjustment to the carrying amounts of assets and liabilities after the period end. Such requirements may be described using terms such as *key sources of estimation uncertainty* or *critical accounting estimates*. They may relate to accounting estimates that require management's most difficult, subjective, or complex judgments. Such judgments may be more subjective and complex, and accordingly, the potential for a consequential material adjustment to the carrying amounts of assets and liabilities may increase, with the number of items of data and assumptions affecting the possible future resolution of the estimation uncertainty. Information that may be disclosed includes the following:
  - — The nature of the assumption or other source of estimation uncertainty
  - — The sensitivity of carrying amounts to the methods and assumptions used, including the reasons for the sensitivity
  - — The expected resolution of an uncertainty and the range of reasonably possible outcomes in respect of the carrying amounts of the assets and liabilities affected
  - — An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved
- The disclosure of the range of possible outcomes and the assumptions used in determining the range.
- The disclosure of specific information, such as

— information regarding the significance of fair value accounting estimates to the entity's financial position and performance, and

— disclosures regarding market inactivity or illiquidity.

- Qualitative disclosures, such as the exposures to risk, and how they arise; the entity's objectives, policies, and procedures for managing the risk and the methods used to measure the risk; and any changes from the previous period of these qualitative concepts.

- Quantitative disclosures, such as the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel, including credit risk, liquidity risk, and market risk.

.A50 *Identified controls over management's process for making accounting estimates (Ref: par. .12*i*).* The auditor's judgment in identifying controls in the control activities component and, therefore, the need to evaluate the design of those controls and determine whether they have been implemented, relates to management's process described in paragraph .12*h*(ii). The auditor may not identify controls in relation to all aspects of paragraph .12*h*(ii). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A51 As part of identifying controls, and evaluating their design and determining whether they have been implemented,[39] the auditor may consider the following:

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.

- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.

- The segregation of duties between those responsible for making the accounting estimates and those committing the entity to the related transactions, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.

- The effectiveness of the design of the controls. Generally, it may be more difficult for management to design controls that address subjectivity and estimation uncertainty in a manner that effectively prevents, or detects and corrects, material misstatements than it is to design controls that address complexity. Controls that address subjectivity and estimation uncertainty may need to include more manual elements, which may be less reliable than automated controls as they can be more easily bypassed, ignored, or

[39] Paragraph 30 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

overridden by management. The design effectiveness of controls addressing complexity may vary depending on the reason for and the nature of the complexity. For example, it may be easier to design more effective controls related to a method that is routinely used or over the integrity of data.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A52 When management makes extensive use of IT in making an accounting estimate, identified controls in the control activities component are likely to include general IT controls and information-processing controls. Such controls may address risks related to the following:

- Whether the IT application or other aspects of the IT environment system has the capability and are appropriately configured to process large volumes of data.
- Complex calculations in applying a method. When diverse IT applications are required to process complex transactions, regular reconciliations between the IT applications are made, in particular, when the IT applications do not have automated interfaces or may be subject to manual intervention.
- Whether the design and calibration of models is periodically evaluated.
- The complete and accurate extraction of data regarding accounting estimates from the entity's records or from external information sources.
- Data, including the complete and accurate flow of data through the entity's information system, the appropriateness of any modification to the data used in making accounting estimates, and the maintenance of the integrity and security of the data; when using external information sources, risks related to processing or recording the data.
- Whether management has controls around access, change, and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorized access or amendments to those models.
- Whether there are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over journal entries.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A53 In some entities, the term *governance* may be used to describe activities within the control environment, the entity's process to monitor the system of internal control, and other components of the system of internal control, as described in SAS No. 145.[40] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[40] Paragraph .A78 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A54 For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of the following:

- The nature and extent of management's use of accounting estimates
- The design and implementation of controls that address the risks related to the data, assumptions, and models used to make the accounting estimates
- The aspects of the entity's information system that generate the data on which the accounting estimates are based
- How new risks relating to accounting estimates are identified, assessed, and managed

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Reviewing the Outcome or Re-Estimation of Previous Accounting Estimates (Ref: par. .13)

.A55 A review of the outcome or re-estimation of previous accounting estimates (retrospective review) assists in identifying and assessing the risks of material misstatement when previous accounting estimates have an outcome through transfer or realization of the asset or liability in the current period or are re-estimated for the purpose of the current period. Through performing a retrospective review, the auditor may obtain the following:

- Information regarding the effectiveness of management's previous estimation process, from which the auditor can obtain audit evidence about the likely effectiveness of management's current process.
- Audit evidence of matters, such as the reasons for changes that may be required to be disclosed in the financial statements.
- Information regarding the complexity, subjectivity, or estimation uncertainty pertaining to the accounting estimates.
- Information regarding the susceptibility of accounting estimates to, or that may be an indicator of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing, and extent of further audit procedures.

.A56 A retrospective review may provide audit evidence that supports the identification and assessment of the risks of material misstatement in the current period. Such a retrospective review may be performed for accounting estimates made for the prior period's financial statements or may be performed over several periods or a shorter period (such as half-yearly or quarterly). In some cases, a retrospective review over several periods may be appropriate when the outcome of an accounting estimate is resolved over a longer period, or when a history of outcomes provides meaningful information or evidence of a trend.

.A57 A retrospective review of management judgments and assumptions related to significant accounting estimates is required by section 240, *Consideration of Fraud in* *a Financial Statement Audit*.[41] As a practical matter, the auditor's review of previous accounting estimates as a risk assessment procedure in accordance with this section may be carried out in conjunction with the review required by section 240.

.A58 Based on the auditor's previous assessment of the risks of material misstatement, for example, if inherent risk is assessed as higher for one or more risks of material misstatement, the auditor may judge that a more detailed retrospective review is required. As part of the detailed retrospective review, the auditor may pay particular attention, when practicable, to the effect of data and significant assumptions used in making the previous accounting estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

.A59 The measurement objective for fair value accounting estimates and other accounting estimates, based on current conditions at the measurement date, deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may, therefore, focus the review on obtaining information that may be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in market participant assumptions that affected the outcome of a previous period's fair value accounting estimates may be unlikely to provide relevant audit evidence. In this case, audit evidence may be obtained by understanding the outcomes of assumptions (such as a cash flow projection) and understanding the effectiveness of management's prior estimation process that supports the identification and assessment of the risk of material misstatement in the current period.

.A60 A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. For example, an entity assumed a forecasted unemployment rate in the development of a loan loss estimate, and the actual losses and unemployment rate differed from that assumed. A difference may represent a misstatement if, for example, the difference arises from information that was available to management when the previous period's financial statements were finalized or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework.[42] Such a difference may call into question management's process for taking information into account in making the accounting estimate. As a result, the auditor may need to reconsider his or her risk assessment or may determine that more persuasive audit evidence needs to be obtained about the matter. Many financial reporting frameworks contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed in each case.

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[41] Paragraph .32*b*(ii) of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[42] Paragraph .15 of section 560, *Subsequent Events*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Specialized Skills or Knowledge (Ref: par. .14)

.A61 Matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge, include, for example, the following:[43]

- The nature of the accounting estimates for a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments, and insurance contract liabilities)
- The degree of estimation uncertainty
- The complexity of the method or model used
- The complexity of the requirements of the applicable financial reporting framework relevant to accounting estimates, including whether there are areas known to be subject to differing interpretation or practice or areas where there are inconsistencies in how accounting estimates are made
- The procedures that the auditor intends to undertake in responding to assessed risks of material misstatement
- The need for judgment about matters not specified by the applicable financial reporting framework
- The degree of judgment needed to select data and assumptions
- The complexity and extent of the entity's use of IT in making accounting estimates

The nature, timing, and extent of the involvement of individuals with specialized skills and knowledge may vary throughout the audit.

.A62 The auditor may not possess the specialized skills or knowledge necessary when the matter involved is in a field other than accounting or auditing (for example, valuation skills) and may need to use an auditor's specialist.[44]

.A63 Many accounting estimates do not require the application of specialized skills or knowledge. For example, specialized skills or knowledge may not be needed for a simple inventory obsolescence calculation. However, for example, for expected credit losses of a banking institution or an insurance contract liability for an insurance entity, the auditor is likely to conclude that it is necessary to apply specialized skills or knowledge.

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .04 and .15)

.A64 Identifying and assessing risks of material misstatement at the assertion level relating to accounting estimates includes not only accounting estimates that are recognized

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[43]Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, and paragraph .08*e* of section 300, *Planning an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[44]See section 620, *Using the Work of an Auditor's Specialist*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

in the financial statements but also those that are included in the notes to the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A65 SAS No. 145 requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement at the assertion level,[45,46] including significant risks, in accordance with section 330. See paragraphs .A148–.A149 of this section for discussion about documentation of inherent risk factors. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A66 As discussed in paragraph .04 of this section, section 200[47] explains that inherent risk is influenced by inherent risk factors. In identifying the risks of material misstatement and in assessing inherent risk for accounting estimates in accordance with SAS No. 145, the auditor is required to take into account the inherent risk factors that affect the susceptibility of assertions to misstatement and how they do so. The auditor's consideration of the inherent risk factors may also provide information to be used in the following:

- Assessing the likelihood and magnitude of misstatement (such as, where inherent risk is assessed on the spectrum of inherent risk)
- Determining the reasons for the assessment given to the risks of material misstatement at the relevant assertion level, and that the auditor's further audit procedures in accordance with paragraph .18 of this section are responsive to those reasons

The interrelationships between the inherent risk factors are further explained in appendix A. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A67 The reasons for the auditor's assessment of inherent risk at the relevant assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Examples follow:

- Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity-specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.

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[45][Footnote renumbered and deleted by the issuance of SAS No. 145, October 2021.]

[46]Paragraphs 31 and 34 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[47]Paragraph .A42 of section 200. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes but may involve little subjectivity, and the degree of estimation uncertainty may be low, depending on the nature of the inventory.
- Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

.A68 The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree, and the auditor may identify fewer risks or assess inherent risk close to the lower end of the spectrum of inherent risk. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A69 Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately, the persuasiveness of the audit evidence needed in responding to the assessed risks. Also, for these accounting estimates, the auditor's application of professional skepticism may be particularly important.

.A70 Events occurring after the date of the financial statements may provide additional information relevant to the auditor's assessment of the risks of material misstatement at the relevant assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the relevant assertion level,[48] regardless of how inherent risk factors affect susceptibility of assertions to misstatement relating to the accounting estimate. Events occurring after the date of the financial statements also may influence the auditor's selection of the approach to testing the accounting estimate in accordance with paragraph .18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may conclude that there is relatively little complexity or subjectivity in making the accounting estimate and, therefore, may assess inherent risk at the relevant assertion level close to the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period-end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[48]Paragraph 37 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A71 The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate, or minimum) or in terms of the auditor's expectation of how effective the controls are in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls.

Estimation Uncertainty (Ref: par. .15a)

.A72 In taking into account the degree to which the accounting estimate is subject to estimation uncertainty, the auditor may consider the following:

- Whether the applicable financial reporting framework requires
  - — the use of a method to make the accounting estimate that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of unobservable inputs.
  - — the use of assumptions that inherently have a high level of estimation uncertainty, such as assumptions with a long forecast period, assumptions that are based on data that are unobservable and, therefore, difficult for management to develop, or the use of various assumptions that are interrelated.
  - — disclosures about estimation uncertainty.
- The business environment. An entity may be active in a market that experiences turmoil or possible disruption (for example, from major currency movements or inactive markets) and the accounting estimate may, therefore, be dependent on data that is not readily observable.
- Whether it is possible (or practicable, insofar as permitted by the applicable financial reporting framework) for management
  - — to make a precise and reliable prediction about the future realization of a past transaction (for example, the amount that will be paid under a contingent contractual term) or about the incidence and impact of future events or conditions (for example, the amount of a future credit loss or the amount at which an insurance claim will be settled and the timing of its settlement), or
  - — to obtain precise and complete information about a present condition (for example, information about valuation attributes that would reflect the perspective of market participants at the date of the financial statements, to develop a fair value estimate).

.A73 The size of the amount recognized or disclosed in the financial statements for an accounting estimate is not, in itself, an indicator of its susceptibility to misstatement because, for example, the accounting estimate may be understated.

.A74 In some circumstances, the estimation uncertainty may be so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may preclude recognition of an item in the financial statements or its measurement at fair value. In such cases, there may be risks of material misstatement that relate not only to whether an accounting estimate should be recognized, or whether it should be measured at fair value, but also to the reasonableness of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the estimation uncertainty associated with them (see paragraphs .A112–.A113 and .A143–.A144).

.A75 In some cases, the estimation uncertainty relating to an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, establishes requirements and provides guidance in such circumstances.

Complexity or Subjectivity (Ref: par. .15b)

The Degree to Which Complexity Affects the Selection and Application of the Method

.A76 In taking into account the degree to which the selection and application of the method used in making the accounting estimate are affected by complexity, the auditor may consider the following:

- The need for specialized skills or knowledge by management, which may indicate that the method used to make an accounting estimate is inherently complex and, therefore, the accounting estimate may have a greater susceptibility to material misstatement. There may be a greater susceptibility to material misstatement when management has developed a model internally and has relatively little experience in doing so or uses a model that applies a method that is not established or commonly used in a particular industry or environment.
- The nature of the measurement basis required by the applicable financial reporting framework, which may result in the need for a complex method that requires multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them. For example, an expected credit loss provision may require judgments about future credit repayments and other cash flows, based on consideration of historical experience data and the application of forward-looking assumptions. Similarly, the valuation of an insurance contract liability may require judgments about future insurance contract payments to be projected based on historical experience and current and assumed future trends.

The Degree to Which Complexity Affects the Selection and Application of the Data

.A77 In taking into account the degree to which the selection and application of the data used in making the accounting estimate are affected by complexity, the auditor may consider the following:

- The complexity of the process to derive the data, taking into account the relevance and reliability of the data source. Data from certain sources may be more reliable than from others. Also, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed.

- The inherent complexity in maintaining the integrity of the data. When there is a high volume of data and multiple sources of data, there may be inherent complexity in maintaining the integrity of data that is used to make an accounting estimate.
- The need to interpret complex contractual terms. For example, the determination of cash inflows or outflows arising from a commercial supplier or customer rebates may depend on very complex contractual terms that require specific experience or competence to understand or interpret.

The Degree to Which Subjectivity Affects the Selection and Application of the Method, Assumptions, or Data

.A78 In taking into account the degree to which the selection and application of method, assumptions, or data are affected by subjectivity, the auditor may consider the following:

- The degree to which the applicable financial reporting framework does not specify the valuation approaches, concepts, techniques, and factors to use in the estimation method.
- The uncertainty regarding the amount or timing, including the length of the forecast period. The amount and timing is a source of inherent estimation uncertainty and gives rise to the need for management judgment in selecting a point estimate, which, in turn, creates an opportunity for management bias. For example, an accounting estimate that incorporates forward-looking assumptions may have a high degree of subjectivity, which may be susceptible to management bias.

Other Inherent Risk Factors (Ref: par. .15b)

.A79 The degree of subjectivity associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. For example, when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more susceptible to misstatement due to management bias or fraud, and this may result in a wide range of possible measurement outcomes. Management may select a point estimate from that range that is inappropriate in the circumstances, or that is inappropriately influenced by unintentional or intentional management bias, and that is, therefore, misstated. For continuing audits, indicators of possible management bias identified during the audit of preceding periods may influence the planning and risk assessment procedures in the current period. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Significant Risks (Ref: par. .16)

.A80 The auditor's assessment of inherent risk, which takes into account the degree to which an accounting estimate is subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, assists the auditor in determining whether any of the risks of material misstatement identified and assessed are a significant risk.

Responses to the Assessed Risks of Material Misstatement

The Auditor's Further Audit Procedures (Ref: par. .17)

.A81 In designing and performing further audit procedures, the auditor may use any of the three testing approaches (individually or in combination) listed in paragraph .17. For example, when several assumptions are used to make an accounting estimate, the auditor may decide to use a different testing approach or combination of testing approaches for each assumption tested.

Obtaining Relevant Audit Evidence, Whether Corroborative or Contradictory

.A82 Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions.[49] Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

.A83 Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of the risk.[50] Therefore, the consideration of the nature or quantity of the audit evidence may be more important when inherent risks relating to an accounting estimate is assessed at the higher end of the spectrum of inherent risk.

.A84 *Scalability.* The nature, timing, and extent of the auditor's further audit procedures are affected by, for example, the following:

- The assessed risks of material misstatement, which affect the persuasiveness of the audit evidence needed and influence the approach the auditor selects to audit an accounting estimate. For example, the assessed risks of material misstatement relating to the existence or valuation assertions may be lower for a straightforward accrual for bonuses that are paid to employees shortly after period-end. In this situation, it may be more practical for the auditor to obtain sufficient appropriate audit evidence by evaluating events occurring up to the date of the auditor's report, rather than through other testing approaches.
- The reasons for the assessed risks of material misstatement.

When the Auditor Intends to Rely on the Operating Effectiveness of Relevant Controls (Ref: par. .18)

.A85 Testing the operating effectiveness of controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This

[49] Paragraphs .A35–.A38 of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[50] Paragraph .07*b* and .A20 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity and, therefore, requires significant judgment by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A86 In determining the nature, timing, and extent of testing of the operating effectiveness of controls relating to accounting estimates, the auditor may consider factors such as the following:

- The nature, frequency, and volume of transactions
- The effectiveness of the design of the controls, including whether controls are appropriately designed to respond to the assessed inherent risk, and the strength of governance
- The importance of particular controls to the overall control objectives and processes in place at the entity, including the sophistication of the information system to support transactions
- The monitoring of controls and identified deficiencies in internal control
- The nature of the risks the controls are intended to address, for example, controls related to the exercise of judgment compared with controls over supporting data
- The competency of those involved in the control activities
- The frequency of performance of the control activities
- The evidence of performance of control activities

Section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. However, section 940 includes guidance and examples of factors that affect the risk associated with a control that may be useful information when determining the nature, timing, and extent of testing of the operating effectiveness of controls relating to accounting estimates.[51]

Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence

.A87 When management makes extensive use of IT to conduct business, it may be more likely that there are risks related to certain accounting estimates for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

[51]Paragraph .A66 of section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A88 Circumstances when risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level may exist include

- when controls are necessary to mitigate risks relating to the initiation, recording, processing, or reporting of information obtained from outside of the general and subsidiary ledgers.
- information supporting one or more assertions is electronically initiated, recorded, processed, or reported. This is likely to be the case when there is a high volume of transactions or data, or a complex model is used, requiring the extensive use of IT to ensure the accuracy and completeness of the information. A complex expected credit loss provision may be required for a financial institution or utility entity. For example, in the case of a utility entity, the data used in developing the expected credit loss provision may comprise many small balances resulting from a high volume of transactions. In these circumstances, the auditor may conclude that sufficient appropriate audit evidence cannot be obtained without testing controls around the model used to develop the expected credit loss provision.

In such cases, the sufficiency and appropriateness of the audit evidence may depend on the effectiveness of controls over the accuracy and completeness of the information.

.A89 As part of the audit of the financial statements for certain entities, the auditor also may be required by law or regulation to undertake additional procedures in relation to, or to provide an assurance conclusion on, internal control. In these and other similar circumstances, the auditor may be able to use information obtained in performing such procedures as audit evidence, subject to determining whether subsequent changes have occurred that may affect its relevance to the audit.

Significant Risks (Ref: par. .19)

.A90 When the auditor's further audit procedures in response to a significant risk consist only of substantive procedures, section 330[52] requires that those procedures include tests of details. Such tests of details may be designed and performed under each of the approaches described in paragraph .17 of this section based on the auditor's professional judgment in the circumstances. Examples of tests of details for significant risks related to accounting estimates include the following:

- Examination, for example, examining contracts to corroborate terms or assumptions
- Recalculation, for example, verifying the mathematical accuracy of a model
- Agreeing assumptions used to supporting documentation, such as third-party published information

[52]Paragraph .22 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Obtaining Audit Evidence From Events Occurring Up to the Date of the Auditor's Report (Ref: par. .20)

.A91 In some circumstances, obtaining audit evidence from events occurring up to the date of the auditor's report may provide sufficient appropriate audit evidence to address the risks of material misstatement. For example, sale of the complete inventory of a discontinued product shortly after the period-end may provide sufficient appropriate audit evidence relating to the estimate of its net realizable value at the period-end. In other cases, it may be necessary to use this testing approach in connection with another approach in paragraph .17.

.A92 For some accounting estimates, events occurring up to the date of the auditor's report are unlikely to provide sufficient appropriate audit evidence regarding the accounting estimate. For example, the conditions or events relating to some accounting estimates develop only over an extended period. Also, because of the measurement objective of fair value accounting estimates, information after the period-end may not reflect the events or conditions existing at the balance sheet date and, therefore, may not be relevant to the measurement of the fair value accounting estimate.

.A93 Even if the auditor decides not to undertake this testing approach in respect of specific accounting estimates, the auditor is required to comply with section 560, *Subsequent Events and Subsequently Discovered Facts*. Section 560 requires the auditor to perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment of or disclosure in the financial statements have been identified[53] and appropriately reflected in the financial statements in accordance with the applicable financial reporting framework.[54] Because the measurement of many accounting estimates, other than fair value accounting estimates, usually depends on the outcome of future conditions, transactions, or events, the auditor's work under section 560 is particularly relevant.

Testing How Management Made the Accounting Estimate (Ref: par. .21)

.A94 Testing how management made the accounting estimate may be an appropriate approach when, for example

- the auditor's review of similar accounting estimates made in the prior-period financial statements suggests that management's current period process is appropriate.
- the accounting estimate is based on a large population of items of a similar nature that individually are not significant.
- the applicable financial reporting framework specifies how management is expected to make the accounting estimate. For example, this may be the case for an expected credit loss provision.
- the accounting estimate is derived from the routine processing of data.

[53] Paragraph .09 of section 560. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[54] Paragraph .11 of section 560. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Testing how management made the accounting estimate may also be an appropriate approach when neither of the other testing approaches is practical to perform or may be an appropriate approach in combination with one of the other testing approaches.

Changes in Methods, Significant Assumptions, and the Data From Prior Periods (Ref: par. .22a, .23a, and .24a)

.A95 The auditor may need to have further discussions with management about the following circumstances and, in doing so, challenge management regarding the appropriateness of the assumptions used:

- When there is a change from prior periods in a method, or significant assumption
- When the data is not based on new circumstances or new information
- When significant assumptions are inconsistent with each other and with those used in other accounting estimates or with related assumptions used in other areas of the entity's business activities

Indicators of Management Bias (Ref: par. .22b, .23b, and .24b)

.A96 When the auditor identifies indicators of possible management bias, the auditor may need a further discussion with management and may need to reconsider whether sufficient appropriate audit evidence has been obtained, indicating that the method, assumptions, and data used were appropriate and supportable in the circumstances. An example of an indicator of management bias for a particular accounting estimate may be when management has developed an appropriate range for several different assumptions, and in each case, the assumption used was from the end of the range that resulted in the most favorable measurement outcome.

Methods

.A97 *The selection of the method (Ref: par. .22*a*).* Relevant considerations for the auditor regarding the appropriateness of the method selected in the context of the applicable financial reporting framework and, if applicable, the appropriateness of changes from the prior period may include the following:

- Whether management's rationale for the method selected is appropriate.
- Whether the method is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, other available valuation concepts or techniques, regulatory requirements, and the business, industry, and environment in which the entity operates.
- When management has determined that different methods result in a range of significantly different estimates, how management has investigated the reasons for these differences.
- Whether the change is based on new circumstances or new information. When this is not the case, the change may not be reasonable or in compliance with the applicable

financial reporting framework. Arbitrary changes result in inconsistent financial statements over time and may give rise to financial statement misstatements or may be an indicator of possible management bias. (See also paragraphs .A133–.A136).

These matters are important when the applicable financial reporting framework does not prescribe the method of measurement or allows multiple methods.

.A98 *Complex modeling (Ref: par. .22*d*).* A model, and the related method, is more likely to be complex when

- understanding and applying the method, including designing the model and selecting and using appropriate data and assumptions, requires specialized skills or knowledge;
- it is difficult to obtain data needed for use in the model because there are restrictions on the availability or observability of, or access to, data; or
- it is difficult to maintain the integrity (for example, accuracy, consistency, or completeness) of the data and assumptions in using the model due to multiple valuation attributes, multiple relationships between them, or multiple iterations of the calculation.

.A99 Matters that the auditor may consider when management uses a complex model include, for example, the following:

- Whether the model is validated prior to usage or when there has been a change to the model, with periodic reviews to ensure it is still suitable for its intended use. The entity's validation process may include evaluation of
  - — the model's theoretical soundness,
  - — the model's mathematical integrity,
  - — the accuracy and completeness of the model's data and assumptions, and
  - — the model's output as compared to actual transactions.
- Whether appropriate change control policies and procedures exist.
- Whether management uses appropriate skills and knowledge in using the model.

.A100 Management may make adjustments to the output of the model to meet the requirements of the applicable financial reporting framework. In some industries these adjustments are referred to as *overlays*. In the case of fair value accounting estimates, it may be relevant to consider whether adjustments to the output of the model, if any, reflect the assumptions market participants would use in similar circumstances.

.A101 *Maintenance of integrity of significant assumptions and the data used in applying the method (Ref: par. .22*e*).* Maintaining the integrity of significant assumptions and the data in applying the method refers to the maintenance of the accuracy and completeness of the data and assumptions through all stages of information processing. A failure to maintain such integrity may result in corruption of the data, and assumptions and may give rise to misstatements. In this regard, relevant considerations for the auditor may include whether the data and assumptions are subject to all changes intended by management, and not subject to any unintended changes, during activities such as input, storage, retrieval, transmission, or processing.

Significant Assumptions (Ref: par. .23)

.A102 Relevant considerations for the auditor regarding the appropriateness of the significant assumptions in the context of the applicable financial reporting framework and, if applicable, the appropriateness of changes from the prior period may include the following:

- Management's rationale for the selection of the assumption.
- Whether the assumption is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, and the business, industry, and environment in which the entity operates.
- Whether a change from prior periods in selecting an assumption is based on new circumstances or new information. When it is not, the change may not be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate may give rise to material misstatements of the financial statements or may be an indicator of possible management bias. (See paragraphs .A133–.A136.)

.A103 Management may evaluate alternative assumptions or outcomes of accounting estimates, which may be accomplished through a number of approaches depending on the circumstances. One possible approach is a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value, there may be variation because different market participants will use different assumptions. A sensitivity analysis may lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, including "pessimistic" and "optimistic" scenarios.

.A104 Through the knowledge obtained in performing the audit, the auditor may become aware of or may have obtained an understanding of assumptions used in other areas of the entity's business. Such matters may include, for example, business prospects, assumptions in strategy documents, and future cash flows. Also, if the engagement partner has performed other engagements for the entity, section 315[55] requires the engagement partner to consider whether information obtained from those other engagements is relevant to identifying risks of material misstatement. This information may also be useful to consider in addressing whether significant assumptions are consistent with each other and with those used in other accounting estimates.

.A105 The appropriateness of the significant assumptions in the context of the requirements of the applicable financial reporting framework may depend on management's intent and ability to carry out certain courses of action. Management often documents plans and

[55]Paragraph .08 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

intentions relevant to specific assets or liabilities, and the applicable financial reporting framework may require management to do so. The nature and extent of audit evidence to be obtained about management's intent and ability is a matter of professional judgment. When applicable, the auditor's procedures may include the following:

- Review of management's history of carrying out its stated intentions
- Inspection of written plans and other documentation, including, when applicable, formally approved budgets, authorizations, or minutes
- Inquiry of management about its reasons for a particular course of action
- Review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report
- Evaluation of the entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments and legal, regulatory, or contractual restrictions that could affect the feasibility of management's actions
- Consideration of whether management has met the applicable documentation requirements, if any, of the applicable financial reporting framework

Certain financial reporting frameworks, however, may not permit management's intentions or plans to be taken into account when making an accounting estimate. This is often the case for fair value accounting estimates because their measurement objective requires that significant assumptions reflect those used by market participants.

.A106 *Data (Ref: par. .24*a*).* Relevant considerations for the auditor regarding the appropriateness of the data selected for use in the context of the applicable financial reporting framework and, if applicable, the appropriateness of the changes from the prior period may include the following:

- Management's rationale for the selection of the data.
- Whether the data is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, and the business, industry, and environment in which the entity operates.
- Whether the change from prior periods in the sources or items of data selected or data selected is based on new circumstances or new information. When it is not, it is unlikely to be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to financial statement misstatements or may be an indicator of possible management bias. (See paragraphs .A133–.A136.)

.A107 *Relevance and reliability of the data (Ref: par. .24*c*).* Section 500 requires the auditor to evaluate information to be used as audit evidence by taking into account, among other things, the relevance and reliability of the information, including its source. The auditor's evaluation of such information to be used as audit evidence is required to include evaluating whether the information is sufficiently precise and detailed for the auditor's purposes and obtaining audit evidence about the accuracy and completeness of the information, as necessary.[56]Paragraphs .A126–.A129 provide further guidance related to evaluating information from external information sources. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A108 *Complex legal or contractual terms (Ref: par. .24*d*).* Procedures that the auditor may consider when the accounting estimate is based on complex legal or contractual terms include the following:

- Considering whether specialized skills or knowledge are needed to understand or interpret the contract
- Inquiring of the entity's legal counsel regarding the legal or contractual terms
- Inspecting the underlying contracts to
  - — evaluate the underlying business purpose for the transaction or agreement, and
  - — consider whether the terms of the contracts are consistent with management's explanations.

Management's Selection of a Point Estimate and Related Disclosures About Estimation Uncertainty

.A109 *Management's steps to understand and address estimation uncertainty (Ref: par. .25*a*).* *Estimation uncertainty* is the susceptibility to an inherent lack of precision in measurement. This arises when the required monetary amount for a financial statement item cannot be measured with precision through direct observation of the cost or price. The susceptibility to a lack of precision in measurement is often referred to in accounting frameworks as *measurement uncertainty*. Relevant considerations regarding whether management has taken appropriate steps to understand and address estimation uncertainty may include whether management has

a. understood the estimation uncertainty, by identifying the sources, and assessing the degree of inherent variability in the measurement outcomes and the resulting range of reasonably possible measurement outcomes;

b. identified the degree to which, in the measurement process, complexity or subjectivity affect the risk of material misstatement, and addressed the resulting potential for misstatement by applying

   i. appropriate skills and knowledge in making accounting estimates, and

   ii. professional judgment, including identifying and addressing susceptibility to management bias; and

[56]Paragraphs .07–.08 of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

c. addressed estimation uncertainty through appropriately selecting management's point estimate and related disclosures that describe the estimation uncertainty.

.A110 *The selection of management's point estimate and related disclosures of estimation uncertainty (Ref: par. .25*b*).* Matters that may be relevant regarding the selection of management's point estimate and the development of related disclosures about estimation uncertainty include whether

- the methods and data used were selected appropriately, including when alternative methods for making the accounting estimate and alternative sources of data were available.
- valuation attributes used were appropriate and complete.
- the assumptions used were selected from a range of reasonably possible amounts and were supported by appropriate data that is relevant and reliable.
- the data used was appropriate, relevant, and reliable, and the integrity of that data was maintained.
- the calculations were applied in accordance with the method and were mathematically accurate.
- management's point estimate is appropriately chosen from the reasonably possible measurement outcomes.
- the related disclosures appropriately describe the amount as an estimate and explain the nature and limitations of the estimation process, including the variability of the reasonably possible measurement outcomes.

.A111 Relevant considerations for the auditor regarding the appropriateness of management's point estimate may include the following:

- When the requirements of the applicable financial reporting framework prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribes a specific measurement method, whether management has followed the requirements of the applicable financial reporting framework
- When the applicable financial reporting framework has not specified how to select an amount from reasonably possible measurement outcomes, whether management has exercised judgment, taking into account the requirements of the applicable financial reporting framework

.A112 Relevant considerations for the auditor regarding management's disclosures about estimation uncertainty include the requirements of the applicable financial reporting framework, which may require disclosures

- that describe the amount as an estimate and explain the nature and limitations of the process for making it, including the variability in reasonably possible measurement outcomes. The framework also may require additional disclosures to meet a disclosure objective.[57]

- about significant accounting policies related to accounting estimates. Depending on the circumstances, relevant accounting policies may include matters such as the specific principles, bases, conventions, rules, and practices applied in preparing and presenting accounting estimates in the financial statements.
- about significant or critical judgments (for example, those that had the most significant effect on the amounts recognized in the financial statements) as well as significant forward-looking assumptions or other sources of estimation uncertainty.

In certain circumstances, additional disclosures beyond those explicitly required by the financial reporting framework may be needed in order to achieve fair presentation, or in the case of a compliance framework, for the financial statements not to be misleading.

.A113 The greater the degree to which an accounting estimate is subject to estimation uncertainty, the more likely the risks of material misstatement will be assessed as higher and, therefore, the more persuasive the audit evidence needs to be to determine, in accordance with paragraph .35, whether management's point estimate and related disclosures about estimation uncertainty are reasonable in the context of the applicable financial reporting framework, or are misstated.

.A114 If the auditor's consideration of estimation uncertainty associated with an accounting estimate, and its related disclosure, is a matter that required significant auditor attention, then this may constitute a key audit matter.[58]

When Management Has Not Taken Appropriate Steps to Understand and Address Estimation Uncertainty (Ref: par. .26)

.A115 When the auditor determines that management has not taken appropriate steps to understand and address estimation uncertainty, additional procedures that the auditor may request management to perform to understand estimation uncertainty may include, for example, consideration of alternative assumptions or the performance of a sensitivity analysis.

.A116 In considering whether it is practicable to develop a point estimate or range, matters that the auditor may need to take into account include whether the auditor could do so without impairing independence.[59] This may include relevant ethical requirements that address prohibitions on assuming management responsibilities.

.A117 If, after considering management's response, the auditor determines that it is not practicable to develop an auditor's point estimate or range, the auditor is required to

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[57]Paragraph 1A of FASB ASC 820-10-50. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[58]See section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[59]See management responsibilities in the "Nonattest Services" interpretation (ET sec. 1.295) under the "Independence Rule" (ET sec. 1.200) of the AICPA Code of Professional Conduct. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with paragraph .34.

*Developing an Auditor's Point Estimate or Using an Auditor's Range (Ref: **par. .27–.28**)*

.A118 Developing an auditor's point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty may be an appropriate approach when, for example

- the auditor's review of similar accounting estimates made in the prior-period financial statements suggests that management's current period process is not expected to be effective.
- the entity's controls within and over management's process for making accounting estimates are not well-designed or properly implemented.
- events or transactions between the period-end and the date of the auditor's report have not been properly taken into account, when it is appropriate for management to do so, and such events or transactions appear to contradict management's point estimate.
- there are appropriate alternative assumptions or sources of relevant data that can be used in developing an auditor's point estimate or a range.
- management has not taken appropriate steps to understand or address the estimation uncertainty (see paragraph .26).

.A119 The decision to develop a point estimate or range also may be influenced by the applicable financial reporting framework, which may prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribe a specific measurement method (for example, the use of a discounted probability-weighted expected value or the most likely outcome).

.A120 The auditor's decision about whether to develop a point estimate, rather than a range, may depend on the nature of the estimate and the auditor's judgment in the circumstances. For example, the nature of the estimate may be such that there is expected to be less variability in the reasonably possible outcomes. In these circumstances, developing a point estimate may be an effective approach, particularly when it can be developed with a higher degree of precision.

.A121 The auditor may develop a point estimate or a range in a number of ways, for example, by

- using a different model than the one used by management, for example, one that is commercially available for use in a particular sector or industry, or a proprietary or auditor-developed model.
- using management's model but developing alternative assumptions or data sources to those used by management.

- using the auditor's own method but developing alternative assumptions to those used by management.
- employing or engaging a person with specialized expertise to develop or execute a model, or to provide relevant assumptions.
- considering other comparable conditions, transactions, or events, or, where relevant, markets for comparable assets or liabilities.

.A122 The auditor also may develop a point estimate or range for only part of the accounting estimate (for example, for a particular assumption or when only a certain part of the accounting estimate is giving rise to the risk of material misstatement).

.A123 When using the auditor's own methods, assumptions, or data to develop a point estimate or range, the auditor may obtain evidence about the appropriateness of management's methods, assumptions, or data. For example, if the auditor uses the auditor's own assumptions in developing a range to evaluate the reasonableness of management's point estimate, the auditor may also develop a view about whether management's judgments in selecting the significant assumptions used in making the accounting estimate give rise to indicators of possible management bias.

.A124 The requirement in paragraph .28*a* for the auditor to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence does not mean that the auditor is expected to obtain audit evidence to support each possible outcome in the range individually. Rather, the auditor is likely to obtain evidence to determine that the points at both ends of the range are reasonable in the circumstances, thereby supporting that amounts falling between those two points also are reasonable.

.A125 The size of the auditor's range may be multiples of materiality for the financial statements as a whole, particularly when materiality is based on operating results (for example, pre-tax income), and this measure is relatively small in relation to assets or other balance sheet measures. This situation is more likely to arise in circumstances in which the estimation uncertainty associated with the accounting estimate is itself multiples of materiality, which is more common for certain types of accounting estimates in which a high degree of estimation uncertainty is more typical, and there may be specific requirements in the applicable financial reporting framework in that regard. Based on the procedures performed and audit evidence obtained in accordance with the requirements of this section, the auditor may conclude that a range that is multiples of materiality is, in the auditor's judgment, appropriate in the circumstances. When this is the case, the auditor's evaluation of the reasonableness of the disclosures about estimation uncertainty becomes increasingly important, particularly whether such disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes. Paragraphs .A139–.A144 include additional considerations that may be relevant in these circumstances.

Other Considerations Relating to Audit Evidence (Ref: par. .30)

.A126 Information to be used as audit evidence, regarding risks of material misstatement relating to accounting estimates, may have been produced by the entity, prepared using the work of a management's specialist, or provided by an external information source.

External Information Sources

.A127 As explained in section 500, the reliability of evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias.[60] Consequently, the nature and extent of the auditor's further audit procedures to consider the reliability of the information used in making an accounting estimate may vary depending on the nature of these factors. Examples follow:

- When market or industry data is obtained from a single external information source specializing in such information, the auditor may seek data from an alternative independent source with which to compare.
- When market or industry data, prices, or pricing-related data are obtained from multiple independent external information sources and points to consensus across those sources, the auditor may need to obtain less evidence about the reliability of the data from an individual source.
- When information obtained from multiple information sources points to divergent market views, the auditor may seek to understand the reasons for the diversity in views. The diversity may result from the use of different methods, assumptions, or data. For example, one source may be using current prices, and another may be using future prices. When the diversity relates to estimation uncertainty, the auditor is required by paragraph .26*b* of this section to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework, the disclosures in the financial statements that describe the estimation uncertainty are reasonable. In such cases, professional judgment is also important in considering information about the methods, assumptions, or data applied.
- When information obtained from an external information source has been developed by that source using its own models (for example, for a derivative instrument or security, a pricing model or cash flow projection model), Statement on Auditing Standards (SAS) No. 142, *Audit Evidence* (sec. 500),[61] provides relevant guidance for the auditor.
- When, for derivative instruments or securities, a pricing source has a relationship with an entity that might impair its objectivity, such as an affiliate or a counterparty involved in selling or structuring the product, the auditor may determine that it is necessary to obtain estimates from more than one pricing source.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

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[60]Paragraph .A22 and appendix A, "Considerations Regarding the Use of External Information Sources," of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[61]Appendix A of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A128 For fair value accounting estimates, additional considerations of the relevance and reliability of information obtained from external information sources may include the following:

a. Whether fair values are based on trades of the same instrument or active market quotations

b. When the fair values are based on transactions of comparable assets or liabilities, how those transactions are identified and considered comparable

c. When there are no transactions either for the asset or liability or comparable assets or liabilities, how the information was developed, including whether the inputs developed and used represent the assumptions that market participants would use when pricing the asset or liability, if applicable

Examples of sources relating to (*a*) and (*b*) for derivative instruments and securities listed on national exchanges or over-the-counter (OTC) markets include financial publications, the exchanges, NASDAQ, or pricing services based on sources such as those. For derivative instruments and securities, if quoted market prices are not available, estimates of fair value frequently may be obtained from, for example, broker-dealers or other third-party sources, based on proprietary valuation models, or from the entity, based on internally or externally developed valuation models (for example, the Black-Scholes option-pricing model). Examples of broker quotes for certain derivative instruments and securities include quoted market prices obtained from broker-dealers who are market makers in such derivative instruments and securities or through electronic quotation and trading systems for OTC securities. However, using such a price quote to test valuation assertions may require special knowledge to understand the circumstances in which the quote was developed. For example, quotations published by electronic quotation and trading systems for OTC securities may not be based on recent trades and may be only an indication of interest and not an actual price for which a counterparty will purchase or sell the underlying derivative instrument or security. Appendix C, "Use of Pricing Information From Third Parties as Audit Evidence," provides further guidance on the use of pricing information from third parties, including brokers or dealers, as audit evidence. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A129 When information from an external information source is used as audit evidence, a relevant consideration for the auditor may be whether information can be obtained, or whether the information is sufficiently detailed, to understand the methods, assumptions, and other data used by the external information source. This may be limited in some respects and consequently influence the auditor's consideration of the nature, timing, and extent of procedures to perform. For example, pricing services often provide information about their methods and assumptions by asset class, rather than individual securities. Brokers often provide only limited information about their inputs and assumptions when providing broker-indicative quotes for individual securities. Section 500[62] provides guidance with respect to restrictions placed by the external information source on the provision of supporting information.

[62] Appendix A of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Management's Specialist

.A130 Assumptions relating to accounting estimates that are made or identified by a management's specialist become management's assumptions when used by management in making an accounting estimate. Accordingly, the auditor applies the relevant requirements in this section to those assumptions.

.A131 If the work of a management's specialist involves the use of methods or sources of data relating to accounting estimates, or developing or providing findings or conclusions relating to a point estimate or related disclosures for inclusion in the financial statements, the requirements in paragraphs .21–.29 of this section may assist the auditor in applying the requirements in section 501 relating to the use of management's specialists.[63]

Service Organizations

.A132 Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, deals with the auditor's understanding of the services provided by a service organization, including internal control, as well as the auditor's responses to assessed risks of material misstatement. When the entity uses the services of a service organization in making accounting estimates, the requirements and guidance in section 402 may assist the auditor in applying the requirements of this section.

Indicators of Possible Management Bias (Ref: par. .32)

.A133 Management bias may be difficult to detect at an account level and may only be identified by the auditor when considering groups of accounting estimates, all accounting estimates in aggregate, or when observed over a number of accounting periods. For example, if accounting estimates included in the financial statements are considered to be individually reasonable but management's point estimates consistently trend toward one end of the auditor's range of reasonable outcomes that provide a more favorable financial reporting outcome for management, such circumstances may indicate possible bias by management.

.A134 Examples of indicators of possible management bias with respect to accounting estimates include the following:

- Changes in an accounting estimate, or the method for making it, when management has made a subjective assessment that there has been a change in circumstances
- Selection or development of significant assumptions or the data that yield a point estimate favorable for management objectives
- Selection of a point estimate that may indicate a pattern of optimism or pessimism

When such indicators are identified, there may be a risk of material misstatement either at the assertion or financial statement level. Indicators of possible management bias

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[63]Paragraph .27*c* of section 501, as amended by SAS No. 142. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

themselves do not constitute misstatements for purposes of drawing conclusions about the reasonableness of individual accounting estimates. However, in some cases, the audit evidence may point to a misstatement, rather than simply an indicator of management bias.

.A135 Indicators of possible management bias may affect the auditor's conclusion about whether the auditor's risk assessment and related responses remain appropriate. The auditor may also need to consider the implications for other aspects of the audit, including the need to further question the appropriateness of management's judgments in making accounting estimates. Further, indicators of possible management bias may affect the auditor's conclusion about whether the financial statements as a whole are free from material misstatement, as discussed in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.[64]

.A136 In addition, in applying section 240, the auditor is required to evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements indicate a possible bias that may represent a material misstatement due to fraud.[65] Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates, which may include intentionally understating or overstating accounting estimates. Indicators of possible management bias that may also be a fraud risk factor may cause the auditor to reassess whether the auditor's risk assessments, in particular, the assessment of fraud risks, and related responses remain appropriate.

Overall Evaluation Based on Audit Procedures Performed (Ref: par. .33)

.A137 As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures.[66] In relation to accounting estimates, information may come to the auditor's attention through performing procedures to obtain audit evidence that differs significantly from the information on which the risk assessment was based. For example, the auditor may have identified that the only reason for an assessed risk of material misstatement is the subjectivity involved in making the accounting estimate. However, while performing procedures to respond to the assessed risks of material misstatement, the auditor may discover that the accounting estimate is more complex than originally contemplated, which may call into question the assessment of the risk of material misstatement (for example, the inherent risk may need to be re-assessed on the higher end of the spectrum of inherent risk due to the effect of complexity) and, therefore, the auditor may need to perform additional further audit procedures to obtain sufficient appropriate audit evidence.[67]

.A138 With respect to accounting estimates that have not been recognized, a particular focus of the auditor's evaluation may be on whether the recognition criteria of the applicable

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[64] Paragraph .14 of section 700 or paragraph .39 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[65] Paragraph .32*b* of section 240. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[66] Paragraph .A73 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[67] See also paragraph .32 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

financial reporting framework have, in fact, been met. When an accounting estimate has not been recognized, and the auditor concludes that this treatment is appropriate, some financial reporting frameworks may require disclosure of the circumstances in the notes to the financial statements.

*Determining Whether the Accounting Estimates Are Reasonable or Misstated (Ref: **par. .35**)*

.A139 In determining whether, based on the audit procedures performed and evidence obtained, management's point estimate and related disclosures are reasonable or are misstated

- when the audit evidence supports a range, the size of the range may be wide and, in some circumstances, may be multiples of materiality for the financial statements as a whole (see also paragraph .A125). Although a wide range may be appropriate in the circumstances, it may indicate that it is important for the auditor to reconsider whether sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range.
- the audit evidence may support a point estimate that differs from management's point estimate. In such circumstances, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement.
- the audit evidence may support a range that does not include management's point estimate. In such circumstances, the misstatement is the difference between management's point estimate and the nearest point of the auditor's range.

.A140 Paragraphs .A110–.A114 provide guidance to assist the auditor in evaluating management's selection of a point estimate and related disclosures to be included in the financial statements.

.A141 When the auditor's further audit procedures include testing how management made the accounting estimate or developing an auditor's point estimate or range, the auditor is required to obtain sufficient appropriate audit evidence about disclosures that describe estimation uncertainty in accordance with paragraphs .25*b* and .28*b* and other disclosures in accordance with paragraph .31. The auditor then considers the audit evidence obtained about disclosures as part of the overall evaluation, in accordance with paragraph .35, of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.

.A142 Section 450 also provides guidance regarding qualitative disclosures[68] and when misstatements in disclosures could be indicative of fraud.[69]

.A143 The auditor's evaluation about whether the financial statements achieve fair presentation[70] includes the consideration of the overall presentation, structure, and content of the financial statements and whether the financial statements, including the related

[68] Paragraph .A23 of section 450. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[69] Paragraph .A24 of section 450. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

notes, represent the transactions and events in a manner that achieves fair presentation. The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. For example, when an accounting estimate is subject to a higher degree of estimation uncertainty, the auditor may determine that additional disclosures are necessary to achieve fair presentation. If management does not include such additional disclosures, the auditor may conclude that the financial statements are materially misstated.

.A144 Section 705[71] provides guidance on the implications for the auditor's opinion when the auditor believes that management's disclosures in the financial statements are inadequate or misleading, including, for example, with respect to estimation uncertainty.

Written Representations

.A145 Part of the auditor's audit evidence related to accounting estimates, as required by section 580, *Written Representations*, includes representations obtained from management about whether management believes the methods, significant assumptions, and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement, or disclosure that is in accordance with the applicable financial reporting framework.[72]

Communication With Those Charged With Governance, Management, or Other Relevant Parties (Ref: par. .37)

.A146 In applying section 260, the auditor communicates with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices relating to accounting estimates and related disclosures.[73]Appendix B, "Communications With Those Charged With Governance," includes matters specific to accounting estimates that the auditor may consider communicating to those charged with governance.

.A147 Section 265 requires the auditor to communicate in writing to those charged with governance significant deficiencies and material weaknesses in internal control identified during the audit.[74] Deficiencies in controls, which may also be significant deficiencies or material weaknesses, may include those related to controls over

a. the selection and application of significant accounting policies and the selection and application of methods, assumptions, and data,

b. risk management and related systems,

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[70]Paragraph .16 of section 700 or paragraph .41 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[71]Paragraphs .23–.24 of section 705. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[72]Paragraph .16 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[73]Paragraph .12*a* of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[74]Paragraph .11 of section 265. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

c. data integrity, including when data is obtained from an external information source, and

d. the use, development, and validation of models, including models obtained from an external provider, and any adjustments that may be required.

Documentation (Ref: par. .38)

.A148 Section 315[75] and section 330[76] provide requirements and guidance on documenting the auditor's understanding of the entity, risk assessments, and responses to assessed risks. This guidance is based on the requirements and guidance in section 230, *Audit Documentation*.[77] In the context of auditing accounting estimates, the auditor is required to prepare audit documentation about key elements of the auditor's understanding of the entity and its environment related to accounting estimates. In addition, the auditor's judgments about the assessed risks of material misstatement related to accounting estimates, and the auditor's responses, may likely be further supported by documentation of communications with those charged with governance and management.

.A149 In documenting the linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level, in accordance with section 330, this section requires that the auditor take into account the reasons given to the risks of material misstatement at the relevant assertion level. Those reasons may relate to one or more inherent risk factors or the auditor's assessment of control risk. However, the auditor is not required to document how every inherent risk factor was taken into account in identifying and assessing the risks of material misstatement in relation to each accounting estimate.

.A150 The auditor also may consider documenting the following:

- When management's application of the method involves complex modeling, whether management's judgments have been applied consistently and, when applicable, that the design of the model meets the measurement objective of the applicable financial reporting framework.
- When the selection and application of methods, significant assumptions, or the data is affected by complexity to a higher degree, the auditor's judgments in determining whether specialized skills or knowledge are required to perform the risk assessment procedures, to design and perform procedures responsive to those risks, or to evaluate the audit evidence obtained. In these circumstances, the documentation also may include how the required skills or knowledge were applied.

.A151 Section 230[78] notes that although there may be no single way in which the auditor's exercise of professional skepticism is documented, the audit documentation

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[75]Paragraphs .33 and .A161–.A164 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[76]Paragraphs .30 and .A77 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[77]Paragraph .09*c* of section 230. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

may, nevertheless, provide evidence of the auditor's exercise of professional skepticism. For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion about the sufficiency and appropriateness of the audit evidence obtained. Examples of other requirements in this section for which documentation may provide evidence of the exercise of professional skepticism by the auditor include the following:

- Paragraph .12*d* of this section, regarding how the auditor has applied an understanding in developing the auditor's own expectation of the accounting estimates and related disclosures to be included in the entity's financial statements and how that expectation compares with the entity's financial statements prepared by management
- Paragraph .17 of this section, which requires further audit procedures to be designed and performed to obtain sufficient appropriate evidence in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory
- Paragraphs .22*b*, .23*b*, .24*b*, and .32 of this section, which address indicators of possible management bias
- Paragraph .34 of this section, which addresses the auditor's consideration of all relevant audit evidence, whether corroborative or contradictory

[78]Paragraph .A9 of section 230. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Appendix A — Inherent Risk Factors

.A152

Introduction

1. In identifying, assessing, and responding to the risks of material misstatement at the relevant assertion level for an accounting estimate and related disclosures, this section requires the auditor to take into account the degree to which the accounting estimate is subject to estimation uncertainty; the degree to which the selection and application of the methods, assumptions, and data used in making the accounting estimate; and the degree to which the selection of management's point estimate and related disclosures for inclusion in the financial statements are affected by complexity, subjectivity, or other inherent risk factors.

2. Inherent risk related to an accounting estimate is the susceptibility of an assertion about the accounting estimate to material misstatement, before consideration of controls. Inherent risk results from inherent risk factors, which give rise to challenges in appropriately making the accounting estimate. This appendix provides further explanation about the nature of the inherent risk factors of estimation uncertainty, subjectivity, and complexity and their interrelationships in the context of making accounting estimates and selecting management's point estimate and related disclosures for inclusion in the financial statements.

Measurement Basis

3. The measurement basis and the nature, condition, and circumstances of the financial statement item give rise to relevant valuation attributes. When the cost or price of the item cannot be directly observed, an accounting estimate is required to be made by applying an appropriate method and using appropriate data and assumptions. The method may be specified by the applicable financial reporting framework, or is selected by management, to reflect the available knowledge about how the relevant valuation attributes would be expected to influence the cost or price of the item on the measurement basis.

Estimation Uncertainty

4. Susceptibility to a lack of precision in measurement may be referred to in accounting frameworks as *measurement uncertainty*. *Estimation uncertainty* is defined in this section as susceptibility to an inherent lack of precision in measurement. It arises when the required monetary amount for a financial statement item that is recognized or disclosed in the financial statements cannot be measured with precision through direct observation of the cost or price. When direct observation is not possible, the next most precise alternative measurement strategy is to apply a method that reflects the available knowledge about cost or price for the item on the relevant measurement basis, using observable data about relevant valuation attributes.

5. However, constraints on the availability of such knowledge or data may limit the verifiability of such inputs to the measurement process and, therefore, limit the precision of measurement outcomes. Furthermore, most accounting frameworks acknowledge that there are practical constraints on the information that should be taken into account, such as when the cost of obtaining it would exceed the benefits. The lack of precision in measurement arising from these constraints is inherent because it cannot be eliminated from the measurement process. Accordingly, such constraints are sources of estimation uncertainty. Other sources of measurement uncertainty that may occur in the measurement process are, at least in principle, capable of elimination if the method is applied appropriately and, therefore, are sources of potential misstatement, rather than estimation uncertainty.

6. When estimation uncertainty relates to uncertain future inflows or outflows of economic benefits that will ultimately result from the underlying asset or liability, the outcome of these flows will only be observable after the date of the financial statements. Depending on the nature of the applicable measurement basis and on the nature, condition, and circumstances of the financial statement item, this outcome may be directly observable before the financial statements are finalized or may only be directly observable at a later date. For some accounting estimates, there may be no directly observable outcome at all.

7. Some uncertain outcomes may be relatively easy to predict with a high level of precision for an individual item. For example, the useful life of a production machine may be easily predicted if sufficient technical information is available about its average useful life. When it is not possible to predict a future outcome, such as an individual's life expectancy based on actuarial assumptions, with reasonable precision, it may still be possible to predict that outcome for a group of individuals with greater precision. Measurement bases may, in some cases, indicate a portfolio level as the relevant unit of account for measurement purposes, which may reduce inherent estimation uncertainty.

Complexity

8. Complexity (that is, the complexity inherent in the process of making an accounting estimate, before consideration of controls) gives rise to inherent risk. Inherent complexity may arise when

- there are many valuation attributes with many or nonlinear relationships between them.
- determining appropriate values for one or more valuation attributes requires multiple data sets.
- more assumptions are required in making the accounting estimate, or when there are correlations between the required assumptions.
- the data used is inherently difficult to identify, capture, access, or understand.

9. Complexity may be related to the complexity of the method and the computational process or model used to apply it. For example, complexity in the model may reflect the need to apply probability-based valuation concepts or techniques, option pricing formulae, or simulation techniques to predict uncertain future outcomes or hypothetical behaviors. Similarly, the computational process may require data from multiple sources or multiple data sets to support the making of an assumption or the application of sophisticated mathematical or statistical concepts.

10. The greater the complexity, the more likely it is that management will need to apply specialized skills or knowledge in making an accounting estimate or engage a management's expert, for example, in relation to

- valuation concepts and techniques that could be used in the context of the measurement basis and objectives or other requirements of the applicable financial reporting framework and how to apply those concepts or techniques;
- the underlying valuation attributes that may be relevant given the nature of the measurement basis and the nature, condition, and circumstances of the financial statement items for which accounting estimates are being made; or
- identifying appropriate sources of data from internal sources (including from sources outside the general or subsidiary ledgers) or from external information sources, determining how to address potential difficulties in obtaining data from such sources or in maintaining its integrity in applying the method, or understanding the relevance and reliability of that data.

11. Complexity relating to data may arise, for example, in the following circumstances:

a. When data is difficult to obtain or when it relates to transactions that are not generally accessible. Even when such data is accessible, for example, through an external information source, it may be difficult to consider the relevance and reliability of the data, unless the external information source discloses adequate information about the underlying data sources it has used and about any data processing that has been performed

b. When data reflecting an external information source's views about future conditions or events, which may be relevant in developing support for an assumption, is difficult to understand without transparency about the rationale and information taken into account in developing those views

c. When certain types of data are inherently difficult to understand because they require an understanding of technically complex business or legal concepts, such as may be required to properly understand data that comprises the terms of legal agreements about transactions involving complex financial instruments or insurance products

Subjectivity

12. Subjectivity (that is, the subjectivity inherent in the process of making an accounting estimate, before consideration of controls) reflects inherent limitations in the knowledge or data reasonably available about valuation attributes. When such limitations exist, the applicable financial reporting framework may reduce the degree of subjectivity by providing a required basis for making certain judgments. Such requirements may, for example, set explicit or implied objectives relating to measurement, disclosure, the unit of account, or the application of a cost constraint. The applicable financial reporting framework may also highlight the importance of such judgments through requirements for disclosures about those judgments.

13. Management judgment is generally needed in determining some or all of the following matters, which often involve subjectivity:

- To the extent not specified under the requirements of the applicable financial reporting framework, the appropriate valuation approaches, concepts, techniques, and factors to use in the estimation method, having regard to available knowledge
- To the extent valuation attributes are observable when there are various potential sources of data, the appropriate sources of data to use
- To the extent valuation attributes are not observable, the appropriate assumptions or range of assumptions to make, considering the best available data, including, for example, market views
- The range of reasonably possible outcomes from which to select management's point estimate, and the relative likelihood that certain points within that range would be consistent with the objectives of the measurement basis required by the applicable financial reporting framework
- The selection of management's point estimate, and the related disclosures to be made, in the financial statements

14. Making assumptions about future events or conditions involves the use of judgment, the difficulty of which varies with the degree to which those events or conditions are uncertain. The precision with which it is possible to predict uncertain future events or conditions depends on the degree to which those events or conditions are determinable based on knowledge, including knowledge of past conditions, events, and related outcomes. The lack of precision also contributes to estimation uncertainty, as described previously.

15. With respect to future outcomes, assumptions will only need to be made for those features of the outcome that are uncertain. For example, in considering the measurement of a possible impairment of a receivable for a sale of goods at the balance sheet date, the amount of the receivable may be unequivocally established and directly observable in the related transaction documents. What may be uncertain is the amount, if any, for loss due to impairment. In this case, assumptions may only be required about the likelihood of loss and the amount and timing of any such loss.

16. However, in other cases, the amounts of cash flows embodied in the rights relating to an asset may be uncertain. In those cases, assumptions may have to be made about both the amounts of the underlying rights to cash flows and about potential losses due to impairment.

17. It may be necessary for management to consider information about past conditions and events, together with current trends and expectations about future developments. Past conditions and events provide historical information that may highlight repeating historical patterns that can be extrapolated in evaluating future outcomes. Such historical information may also indicate changing patterns of such behavior over time (cycles or trends). These may suggest that the underlying historical patterns of behavior have been changing in somewhat predictable ways that may also be extrapolated in evaluating future outcomes. Other types of information may also be available that indicate possible changes in historical patterns of such behavior or in related cycles or trends. Difficult judgments may be needed about the predictive value of such information.

18. The extent and nature (including the degree of subjectivity involved) of the judgments taken in making the accounting estimates may create opportunity for management bias in making decisions about the course of action that, according to management, is appropriate in making the accounting estimate. When there is also a high level of complexity or a high level of estimation uncertainty, or both, the risk of and opportunity for management bias or fraud may also be increased.

Relationship of Estimation Uncertainty to Subjectivity and Complexity

19. Estimation uncertainty gives rise to inherent variation in the possible methods, data sources, and assumptions that could be used to make an accounting estimate. This gives rise to subjectivity and, hence, the need for the use of judgment in making the accounting estimate. Such judgments are required in selecting the appropriate methods and data sources, in making the assumptions, and in selecting management's point estimate and related disclosures for inclusion in the financial statements. These judgments are made in the context of the recognition, measurement, presentation, and disclosure requirements of the applicable financial reporting framework. However, because there are constraints on the availability and accessibility of knowledge or information to support these judgments, they are subjective in nature.

20. Subjectivity in such judgments creates the opportunity for unintentional or intentional management bias in making them. Many accounting frameworks require that information prepared for inclusion in the financial statements should be neutral (that is, it should not be biased). Given that bias can, at least in principle, be eliminated from the estimation process, sources of potential bias in the judgments made to address subjectivity are sources of potential misstatement, rather than sources of estimation uncertainty.

21. The inherent variation in the possible methods, data sources, and assumptions that could be used to make an accounting estimate (see paragraph 19) also gives rise to variation in the possible measurement outcomes. The size of the range of reasonably possible measurement outcomes results from the degree of estimation uncertainty and is often referred to as the *sensitivity of the accounting estimate*. In addition to determining measurement outcomes, an estimation process also involves analyzing the effect of inherent variations in the possible methods, data sources, and assumptions on the range of reasonably possible measurement outcomes (referred to as *sensitivity analysis*).

22. Developing a financial statement presentation for an accounting estimate, which, when required by the applicable financial reporting framework, achieves faithful representation (that is, complete, neutral, and free from error) includes making appropriate judgments in selecting a management point estimate that is appropriately chosen from within the range of reasonably possible measurement outcomes and related disclosures that appropriately describe the estimation uncertainty. These judgments may themselves involve subjectivity, depending on the nature of the requirements in the applicable financial reporting framework that address these matters. For example, the applicable financial reporting framework may require a specific basis (such as a probability-weighted average or a best estimate) for the selection of the management point estimate. Similarly, it may require specific disclosures or disclosures that meet specified disclosure objectives or additional disclosures that are required to achieve fair presentation in the circumstances.

23. Although an accounting estimate that is subject to a higher degree of estimation uncertainty may be less precisely measurable than one subject to a lower degree of estimation uncertainty, the accounting estimate may still have sufficient relevance for users of the financial statements to be recognized in the financial statements if, when required by the applicable financial reporting framework, a faithful representation of the item can be achieved. In some cases, estimation uncertainty may be so great that the recognition criteria in the applicable financial reporting framework are not met, and the accounting estimate cannot be recognized in the financial statements. Even in these circumstances, there may still be relevant disclosure requirements, for example, to disclose the point estimate or range of reasonably possible measurement outcomes and information describing the estimation uncertainty and constraints in recognizing the item. The requirements of the applicable financial reporting framework that apply in these circumstances may be specified to a greater or lesser degree. Accordingly, in these circumstances, there may be additional judgments that involve subjectivity to be made.

Appendix B — Communications With Those Charged With Governance (Ref: par. .A146)

.A153

1. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance the auditor's views about the qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.[1]Section 260[2] also identifies matters that may be communicated as part of this communication. The following is a list of additional matters that the auditor may consider communicating with those charged with governance with respect to the auditor's views about significant qualitative aspects of the entity's accounting practices related to accounting estimates and related disclosures:

- How management identifies transactions, other events, and conditions that may give rise to the need for or changes in accounting estimates and related disclosures
- Risks of material misstatement
- The relative materiality of the accounting estimates to the financial statements as a whole
- Management's understanding (or lack thereof) regarding the nature and extent of and the risks associated with accounting estimates
- Whether management has applied appropriate specialized skills or knowledge or engaged appropriate experts
- The auditor's views about differences between the auditor's point estimate or range and management's point estimate
- The auditor's views about the appropriateness of the selection of accounting policies related to accounting estimates and presentation of accounting estimates in the financial statements
- Indicators of possible management bias
- Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates
- When there has been a change from the prior period in the methods for making the accounting estimate, why, as well as the outcome of accounting estimates in prior periods
- Whether management's methods for making the accounting estimates, including when management has used a model, are appropriate in the context of the measurement

[1]Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[2]The appendix, "Qualitative Aspects of Accounting Practices," of section 260.

objectives; the nature, conditions, and circumstances; and other requirements of the applicable financial reporting framework

- The nature and consequences of significant assumptions used in accounting estimates and the degree of subjectivity involved in the development of the assumptions
- Whether significant assumptions are consistent with each other and with those used in other accounting estimates or with assumptions used in other areas of the entity's business activities
- When relevant to the appropriateness of the significant assumptions or the appropriate application of the applicable financial reporting framework, whether management has the intent to carry out specific courses of action and has the ability to do so
- How management has considered alternative assumptions or outcomes and why it has rejected them or how management has otherwise addressed estimation uncertainty in making the accounting estimate
- Whether the data and significant assumptions used by management in making the accounting estimates are appropriate in the context of the applicable financial reporting framework
- The relevance and reliability of information obtained from an external information source
- Significant difficulties encountered when obtaining sufficient appropriate audit evidence relating to data obtained from an external information source or valuations performed by management or management's expert
- Significant differences in judgments between the auditor and management or management's expert regarding valuations
- The potential effects on the entity's financial statements of material risks and exposures required to be disclosed in the financial statements, including the estimation uncertainty associated with accounting estimates
- The reasonableness of disclosures about estimation uncertainty in the financial statements
- Whether management's decisions relating to the recognition, measurement, presentation, and disclosure of the accounting estimates and related disclosures in the financial statements are in accordance with the applicable financial reporting framework

Appendix C — Use of Pricing Information From Third Parties as Audit Evidence

.A154

1. Section 500, *Audit Evidence*, contains requirements and provides guidance about evaluating information to be used as audit evidence, including information from external information sources. This section provides guidance on complying with section 500 with respect to information to be used as audit evidence relating to accounting estimates, without regard to the sources of information. As explained in section 500, the reliability of evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias. This appendix provides additional guidance about information used as audit evidence for estimates, when that information is pricing information obtained from external information sources.

2. When the auditor uses pricing information from an external information source to develop an independent expectation or evaluates pricing information provided by a third party used by the entity, the requirement in section 500[1] to evaluate information to be used as audit evidence applies. Quoted market prices for derivative instruments and securities listed on national exchanges or over-the-counter markets that are obtained from sources such as financial publications, the exchanges, NASDAQ, or pricing services based on sources such as these generally provide sufficient evidence of the fair value of the derivative instruments and securities. The following paragraphs provide guidance for evaluating pricing information from the following sources:

a. Organizations that routinely provide uniform pricing information to users, generally on a subscription basis (pricing services). Note that when a pricing service is engaged to individually develop a price for a specific financial instrument not routinely priced for its subscribers, the requirements in sections 501, *Audit Evidence — Specific Considerations for Selected Items*, and 620, *Using the Work of an Auditor's Specialist*, relating to management's or the auditor's specialist, respectively, apply.

b. Brokers or dealers.

Using Pricing Information From Pricing Services

3. Appendix A, "Considerations Regarding the Use of External Information Sources," of section 500 provides guidance relevant to evaluating the reliability of information from external information sources. The reliability of information to be used as audit evidence depends on the nature and source of the information and the circumstances under which it is obtained. The following factors affect the reliability of pricing information provided by a pricing service:

[1]Paragraph .07 of section 500, *Audit Evidence*.

a. The experience and expertise of the pricing service relative to the types of financial instruments being valued, including whether the types of financial instruments being valued are routinely priced by the pricing service

b. Whether the methodology used by the pricing service in determining fair value of the types of financial instruments being valued is in accordance with the applicable financial reporting framework

c. Whether the pricing service has a relationship with the entity by which management has the ability to influence the pricing service

4. The procedures performed under section 550, *Related Parties*, can assist the auditor in evaluating the reliability of the audit evidence obtained from the pricing service by taking into account the ability of management to influence the information obtained from the pricing service through relationships between the entity and the pricing service. The existence of a process by which subscribers can challenge a pricing service's pricing information does not, by itself, mean that management has the ability to influence that pricing service.

5. If the auditor performs procedures to assess the reliability of pricing information provided by a pricing service at an interim date, the auditor may determine it necessary to evaluate whether the pricing service has changed its valuation process relative to the types of financial instruments being valued and, if so, the effect of such changes on the pricing information provided at period end.

6. The relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested. The following factors affect the relevance of pricing information provided by a pricing service:

a. Whether the fair values are based on quoted prices in active markets for identical financial instruments

b. When the fair values are based on transactions of similar financial instruments, how those transactions are identified and considered comparable to the financial instruments being valued

c. When no recent transactions have occurred for either the financial instrument being valued or similar financial instruments or the price was developed using a nonbinding quote from a broker or dealer, how the fair value was developed, including whether the inputs used represent the assumptions that market participants would use when pricing the financial instruments

7. Fair values of financial instruments based on trades of identical financial instruments in an active market have a lower risk of material misstatement than fair values derived from observable trades of similar financial instruments or unobservable inputs. When the fair values are based on transactions of similar financial instruments, audit procedures to evaluate the process used by the pricing service may include evaluating how transactions are identified, considered comparable, and used to value the types of financial instruments selected for testing.

8. When financial instruments are similar, and are priced by the pricing service using the same process, procedures related to the information from the pricing service may be performed for financial instruments as a group, rather than for each instrument individually. Considerations for determining the similarity of the financial instruments include the following matters:

- The terms and characteristics of the financial instruments
- The extent to which the fair value of the type of financial instrument is based on inputs that are observable directly or indirectly
- Other factors affecting the valuation of the financial instruments, such as credit or counterparty risk, market risk, and liquidity risk

9. When no recent transactions have occurred for either the financial instrument being valued or similar financial instruments, audit procedures may include evaluating the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs used by the pricing service.

Using Pricing Information From Multiple Pricing Services

10. When pricing information is obtained from multiple pricing services (that is, more than one), less information may be needed about the particular methods and inputs used by the individual pricing services based on the presence of factors such as the following:

a. There are recent trades of the financial instrument or of financial instruments substantially similar to the financial instruments being valued.

b. The type of financial instrument being valued is routinely priced by several (that is, more than two) pricing services.

c. Prices obtained are reasonably consistent across pricing services, taking into account the nature and characteristics of the financial instruments being valued, and market conditions.

d. The pricing information for the type of financial instrument is generally based on inputs that are observable.

11. When one or more of the preceding factors are not present, further audit procedures may be necessary to evaluate the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs for a representative price for the type of financial instrument being valued.

Using Pricing Information From a Broker or Dealer

12. When a fair value measurement is based on a quote from a broker or dealer (broker quote), the relevance and reliability of the evidence provided by the broker quote depend on whether

a. the broker or dealer has a relationship with the entity by which management has the ability to influence the broker or dealer;

b. the broker or dealer making the quote is a market maker that transacts in the same type of financial instrument;

c. the broker quote reflects market conditions as of the date of the financial statements;

d. the broker quote is binding on the broker or dealer; and

e. there are any restrictions, limitations, or disclaimers in the broker quote and, if so, their nature.

13. Broker quotes generally provide more relevant and reliable evidence when they are timely, binding quotes, without any restrictions, limitations, or disclaimers, from unaffiliated market makers transacting in the same type of financial instrument. If the broker quote does not provide sufficient appropriate audit evidence, additional procedures the auditor may perform include obtaining relevant and reliable pricing information from another pricing source.

14. The procedures performed under section 550 can assist the auditor in evaluating the reliability of the audit evidence obtained from the broker or dealer by taking into account the ability of management to influence the information obtained from the broker or dealer through relationships between the entity and the broker or dealer.

Unobservable Inputs

15. When the valuation of a financial instrument includes unobservable inputs that are significant to the valuation, obtaining an understanding of how unobservable inputs were determined and evaluating the reasonableness of the unobservable inputs may include taking into account the following:

a. Whether modifications made to observable information generally reflect the assumptions that market participants would use when pricing the financial instrument, including assumptions about risk

b. How management determined its fair value measurement, including whether it appropriately considered the information available

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

AU-C Section 550

Related Parties

Source: SAS No. 122; SAS No. 128; SAS No. 135; SAS No. 136; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

> **Note**
> In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.
>
> The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements.[1] Specifically, it expands on how section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; and section 240, *Consideration of Fraud in a Financial Statement Audit*, are to be applied regarding risks of material misstatement associated with related party relationships and transactions.

.02 Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, requires the auditor to evaluate whether the financial statements achieve fair presentation.[2]Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*,

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[1]The phrase "related party relationships and transactions" as used in generally accepted auditing standards is intended to have the same meaning as the phrase "related parties and relationships and transactions with related parties" as used in the auditing standards of the PCAOB. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

requires that, in audits of special purpose financial statements that contain related party transactions, the auditor evaluate whether the financial statements include informative disclosures similar to those required by generally accepted accounting principles (GAAP).[3]Section 800 also requires the auditor to evaluate whether additional disclosures beyond those specifically required by the framework and related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the financial statements to achieve fair presentation.[4] Thus, this section applies to all audits of financial statements. (Ref: par. .A1–.A3) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Nature of Related Party Relationships and Transactions (Ref: par. .A1–.A6)

.03 Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example

- related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- related party transactions may not be conducted under normal market terms and conditions (for example, some related party transactions may be conducted with no exchange of consideration).
- related party transactions may be motivated solely or in large measure to engage in fraudulent financial reporting or conceal misappropriation of assets.

Responsibilities of the Auditor

.04 Because related parties are not independent of each other, financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions, and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Therefore, the auditor has a responsibility to perform audit procedures to identify, assess,

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[2]Paragraph .16 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .41 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. [Footnote renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[3]Paragraph .17 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[4]Paragraph .17 of section 800. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions, or balances. (Ref: par. .A3)

.05 In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present, as required by section 240, because fraud may be more easily committed through related parties.[5]

.06 Owing to the inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with generally accepted auditing standards (GAAS).[6] In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater because of reasons such as the following:

- Management may be unaware of the existence of all related party relationships and transactions.
- Related party relationships may present a greater opportunity for collusion, concealment, or manipulation by management.

.07 Planning and performing the audit with professional skepticism as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, is, therefore, particularly important in this context, given the potential for undisclosed related party relationships and transactions.[7] The requirements in this section are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions and in designing audit procedures to respond to the assessed risks.

Effective Date

.08 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.09 The objectives of the auditor are to

a. obtain an understanding of related party relationships and transactions sufficient to be able to

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[5]Paragraph .24 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[6]Paragraph .A56 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[7]Paragraph .17 of section 200. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

i. recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud.

ii. conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions, achieve fair presentation.

b. obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for, and disclosed in the financial statements.

Definitions

.10 For purposes of GAAS, the following terms have the meanings attributed as follows:

Arm's length transaction. A transaction conducted on such terms and conditions between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

Related party. A party defined as a related party in GAAP. (Ref: par. .A1)

.11 Reference to GAAP in GAAS means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Risk Assessment Procedures and Related Activities

.12 As part of the risk assessment procedures and related activities that section 240 and section 315A require the auditor to perform during the audit, the auditor should perform the audit procedures and related activities set out in paragraphs .13–.19 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions.[8,9]

Understanding the Entity's Related Party Relationships and Transactions

.13 In connection with the engagement team discussion(s) that section 240 and section 315A require, the auditor should include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.[10,11] (Ref: par. .A7–.A8)

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[8]Paragraph .16 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[9]Paragraph .05 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

.14 The auditor should inquire of management and others within the entity regarding the following:

a. The identity of the entity's related parties, including changes from the prior period (Ref: par. .A9–.A15)

b. The nature of the relationships (including ownership structure) between the entity and these related parties

c. The business purpose of entering into a transaction with a related party versus an unrelated party

d. Whether the entity entered into, modified, or terminated any transactions with these related parties during the period and, if so, the type and business purpose of the transactions

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.15 The auditor should inquire of management and others within the entity and perform other risk assessment procedures[12] considered appropriate to obtain an understanding of the controls, if any, that management has established to (Ref: par. .A16–.A21)

a. identify, account for, and disclose related party relationships and transactions.

b. authorize and approve significant transactions and arrangements with related parties. (Ref: par. .A22)

c. authorize and approve significant unusual transactions, and arrangements outside the normal course of business.

Inquiries should include asking about any related party transactions

a. that have not been authorized and approved in accordance with the entity's established policies or procedures regarding the authorization and approval of transactions with related parties.

b. for which exceptions to the entity's established policies or procedures were granted and the reasons for granting those exceptions. (Ref: par. .A44–.A45)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.16 Unless all of those charged with governance are involved in managing the entity, the auditor should inquire of those charged with governance (or the audit committee or, at least, its chair) regarding

[10] Paragraph .15 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[11] Paragraph .11 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[12] Paragraph .06 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

a. their understanding of the entity's relationships and transactions with related parties that are significant to the entity and

b. whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Remaining Alert for Related Party Information When Reviewing Records or Documents

.17 During the audit, the auditor should remain alert when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. In particular, the auditor should inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (Ref: par. .A23–.A25)

a. Bank and legal confirmations obtained as part of the auditor’s procedures

b. Minutes of meetings of shareholders and of those charged with governance and summaries of actions of recent meetings for which minutes have not yet been prepared

c. Such other records or documents as the auditor considers necessary in the circumstances of the entity

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.18 If the auditor identifies significant unusual transactions when performing the audit procedures required by paragraph .17 or through other audit procedures, the auditor should inquire of management about the following: (Ref: par. .A26–.A27)

a. The nature of these transactions (Ref: par. .A28)

b. Whether related parties could be involved (Ref: par. .A29)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Sharing Related Party Information With the Engagement Team

.19 The auditor should share with the other members of the engagement team the identity of the entity’s related parties and other relevant information obtained about the related parties. (Ref: par. .A30–.A31) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification and Assessment of the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

.20 In meeting the requirement of section 315A to identify and assess the risks of material misstatement, the auditor should identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks.[13] In making this determination, the auditor should treat identified related party transactions that are also significant unusual transactions as giving rise to significant risks. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.21 If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor should consider such information when identifying and assessing the risks of material misstatement due to fraud, in accordance with section 240.[14] (Ref: par. .A32–.A34) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

.22 As part of the requirement in section 330 that the auditor respond to assessed risks, the auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. The auditor should evaluate whether the entity has properly identified its related party relationships and transactions. Evaluating whether an entity has properly identified its related party relationships and transactions involves more than assessing the process used by the entity. The evaluation should include procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity, taking into account the information gathered during the audit.[15] (Ref: par. .A35–.A38) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.23 The auditor should perform procedures on balances with affiliated entities as of concurrent dates, even if fiscal years of the respective entities differ. The procedures performed should address the risks of material misstatement associated with the entity's accounts with affiliates. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

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[13]Paragraph .26 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[14]Paragraph .24 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[15]Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

.24 If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor should determine whether the underlying circumstances confirm the existence of those relationships or transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.25 If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor should

a. promptly communicate the relevant information to the other members of the engagement team. (Ref: par. .A30 and .A39)

b. request management to identify all transactions with the newly identified related parties for the auditor's further evaluation.

c. inquire why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions.

d. perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions. (Ref: par. .A40)

e. reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor and perform additional audit procedures as necessary.

f. evaluate the implications for the audit if the nondisclosure by management appears intentional (and, therefore, indicative of a risk of material misstatement due to fraud). (Ref: par. .A41)

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identified Related Party Transactions That Are Required to Be Disclosed or Determined to be a Significant Risk

.26 For identified significant related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk, the auditor should[16]

a. read the underlying contracts or agreements, if any, and evaluate whether

   i. the business purpose (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.[17] (Ref: par. .A42–.A43)

[16]See paragraph .21, which requires the auditor to treat identified related party transactions that are also significant unusual transactions as giving rise to significant risks. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

ii. the terms of the transactions are consistent with management's explanations.

iii. the transactions have been appropriately accounted for and disclosed.

b. obtain audit evidence that the transactions have been appropriately authorized and approved. (Ref: par. .A44–.A45)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction

.27 If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor should obtain sufficient appropriate audit evidence about the assertion. (Ref: par. .A46–.A50) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of the Accounting for, and Disclosure of, Identified Related Party Relationships and Transactions

.28 In forming an opinion on the financial statements, in accordance with section 700, or section 703, the auditor should evaluate the following:[18] (Ref: par. .A51)

a. Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed (Ref: par. .A52)

b. Whether the effects of the related party relationships and transactions prevent the financial statements from achieving fair presentation (Ref: par. .A3)

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Communication With Those Charged With Governance

.29 Unless all of those charged with governance are involved in managing the entity, the auditor should communicate with those charged with governance significant findings or issues arising during the audit in connection with the entity's related parties.[19] (Ref: par. .A53) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

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[17]Paragraph .32*c* of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[18]Paragraphs .12–.17 of section 700, or paragraphs .37–.42 of section 703, as applicable. [Footnote renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[19]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

Documentation

.30 The auditor should include in the audit documentation the names of the identified related parties and the nature of the related party relationships.[20] [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Application and Other Explanatory Material

Nature of Related Party Relationships and Transactions (Ref: par. .02–.04, .10, and .28b)

.A1 GAAP frameworks include or refer to specific disclosure requirements for related party relationships and transactions. If the applicable financial reporting framework does not have specific disclosure requirements, the auditor, nonetheless, evaluates whether related party information is disclosed in a manner comparable to GAAP in order for the financial statements to achieve fair presentation.[21]

.A2 Certain accounting pronouncements prescribe the accounting treatment when related parties are involved; however, established accounting principles ordinarily do not require transactions with related parties to be accounted for on a basis different from that which would be appropriate if the parties were not related. In addition, the substance of a particular transaction may be significantly different from its form. Accordingly, financial statements prepared in accordance with GAAP generally recognize the substance of particular transactions rather than merely their legal form.

.A3 Related party relationships and transactions may cause the financial statements to fail to achieve fair presentation if, for example, the economic substance of such relationships and transactions is not appropriately reflected in the financial statements. For instance, fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A4 Transactions that because of their nature may be indicative of the existence of related parties include the following:

a. Borrowing or lending on an interest free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction

b. Selling real estate at a price that differs significantly from its appraised value

c. Exchanging property for similar property in a nonmonetary transaction

[20] Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[21] Paragraph .17 of section 800. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

d. Making loans with no scheduled terms for when or how the funds will be repaid

.A5 Although many related party transactions are in the normal course of business, a possibility exists that transactions with related parties may have been motivated solely or in large measure by conditions similar to the following:

a. Lack of sufficient working capital or credit to continue the business

b. An overly optimistic earnings forecast

c. Dependence on a single or relatively few products, customers, or transactions for the continued success of the venture

d. A declining industry characterized by a large number of business failures

e. Excess capacity

f. Significant litigation, especially litigation between stockholders and management

g. Significant obsolescence dangers because the company is in a high technology industry

For these reasons, related party transactions may indicate an increased risk of material misstatement of the financial statements.

Considerations Specific to Governmental Entities

.A6 For state and local governmental entities, related party relationships and transactions can result from interactions with other governments, not-for-profit entities, for-profit entities, and individuals. The applicable financial reporting framework used by most state and local governmental entities addresses related party relationships and transactions using terms that include *related parties*, *related organizations*, and *component units*, and can result in the inclusion of the related parties' financial statements as a reporting unit, inclusion within a reporting unit, disclosure of the related party transactions, or disclosure about why the related party or its transactions are not included. In all such cases, the objectives described in paragraph .09 are relevant to the auditor.

Risk Assessment Procedures and Related Activities

Understanding the Entity's Related Party Relationships and Transactions

Discussion Among the Engagement Team (Ref: par. .13)

.A7 Matters that may be addressed in the discussion among the engagement team include the following:

- The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit)

- An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions
- The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (for example, a complex organizational structure, use of entities formed to accomplish specific purposes,[22] or an inadequate information system)
- The records or documents that may indicate the existence of related party relationships or transactions
- The importance that management and those charged with governance attach to the identification of, appropriate accounting for, and disclosure of related party relationships and transactions and the related risk of management override of controls

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A8 In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

- Entities formed to accomplish specific purposes and that are controlled by management might be used to facilitate earnings management.
- Transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.
- As indicated in paragraph .A2, the form of a related party transaction may mask its substance. For example, equity distributions or capital contributions may be structured as loans.
- Related party transactions may be subject to period-end window dressing. For example, a stockholder may pay a loan shortly before period-end, but the entity loans the same amount to the stockholder shortly after period-end.
- Certain entities, such as governmental entities or entities operating in regulated industries, may circumvent laws or regulations that limit or restrict their ability to engage in transactions with related parties.

The Identity of the Entity's Related Parties (Ref: par. .14a)

.A9 Information regarding the identity of the entity's related parties is likely to be readily available to management if the entity's information systems record, process, and summarize related party relationships and transactions to enable the entity to meet applicable disclosure requirements. Therefore, management may have a comprehensive list of related

[22]Entities formed to accomplish specific purposes are discussed in paragraphs .A27–.A28 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

parties and changes from the prior period. For recurring engagements, making the inquiries specified by paragraph .14 provides a basis for comparing the information supplied by management with the auditor's record of related parties noted in previous audits.

.A10 However, if the entity does not have such information systems in place, management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph .14 still applies because management may be aware of parties that meet the related party definition set out in GAAP. In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, to obtain information regarding the entity's organizational structure, ownership, governance, and business model.[23]

In the particular case of common control relationships, because management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions or shares resources to a significant degree are related parties. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A11 In the context of a group audit, section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, requires the group engagement team to provide each component auditor with information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties.[24] When the entity is a component within a group, this information provides a useful basis for the auditor's inquiries of management regarding the identity of the entity's related parties. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A12 The auditor also may obtain some information regarding the identity of the entity's related parties through inquiries of management during the engagement acceptance or continuance process.

.A13 Section 580, *Written Representations*, addresses requirements to obtain management representations, including representations that management and, when appropriate, those charged with governance have[25]

a. disclosed to the auditor the identity of the entity's related parties and all the related party relationships of which they are aware.

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[23]Paragraph .12 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[24]Paragraph .41*c* of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[25]Paragraph .17 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

b. appropriately accounted for and disclosed such relationships and transactions.

.A14 The inquiry about the identity of the entity's related parties may include background information concerning the related parties, for example, physical location, industry, size, and extent of operations. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A15 *Considerations specific to governmental entities.* Because of the variety of the types of relationships and transactions among governmental and other entities, some of which are highly complex, identifying the nature of the related party relationship and its appropriate treatment in the financial statements relies heavily on a governmental entity's application of its financial reporting framework. Further, in some circumstances, the governmental entity may have no legal jurisdiction over the related party even when the application of the financial reporting framework concludes that the related party's financial statements are to be included in the governmental entity's financial statements. In such cases, the auditor's inquiries regarding the identity of the entity's related parties are likely to include the concepts and guidance from the applicable financial reporting framework to assist in making appropriate assessments about the existence and nature of related party relationships. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

The Entity's Controls Over Related Party Relationships and Transactions (Ref: par. .15)

.A16 Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions and the entity's controls over such relationships and transactions, as well as the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor, and whether such relationships or transactions were with known or previously unknown related parties. These may include, to the extent that they do not form part of management, the following:

- Those charged with governance
- Personnel in a position to initiate, authorize, process, or record significant unusual transactions and those who supervise or monitor such personnel
- The internal audit function
- In-house legal counsel
- The chief ethics officer or equivalent person
- Chief compliance officer
- The human resources director or equivalent person

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A17 The audit is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for 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.[26] Accordingly, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement, and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business purpose of the entity's related party relationships and transactions. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A18 In meeting the requirement of section 315A to obtain an understanding of internal control, the auditor may consider features or elements relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as the following:[27]

- Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions
- Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions
- The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions
- Timely disclosure and discussion between management and those charged with governance of related party transactions that are also significant unusual transactions, including whether those charged with governance have appropriately challenged the business purpose of such transactions (for example, by seeking advice from external professional advisors)
- Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management
- Periodic reviews by the internal audit function, when applicable
- Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel
- The existence of whistle-blowing policies and procedures, when applicable

[26] Paragraphs .05 and .A2 of section 200. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]
[27] Paragraph .13 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A19 Controls over related party relationships and transactions within some entities may be deficient or nonexistent for a number of reasons, such as the following:

- The low importance attached by management to identifying and disclosing related party relationships and transactions
- The lack of appropriate oversight by those charged with governance
- An intentional disregard for such controls because related party disclosures may reveal information that management considers sensitive (for example, the existence of transactions involving family members of management)
- An insufficient understanding by management of the applicable related party disclosure requirements

When such controls are ineffective or nonexistent, the auditor may be unable to obtain sufficient appropriate audit evidence about related party relationships and transactions. If this were the case, the auditor would, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, consider the implications for the audit, including the opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A20 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.[28] The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management's financial interests in certain related parties may provide incentives for management to override controls by (*a*) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (*b*) colluding with such parties or controlling their actions. Examples of possible fraud include the following:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business purpose of these transactions
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value
- Engaging in complex transactions with related parties, such as entities formed to accomplish specific purposes, that are structured to misrepresent the financial position or financial performance of the entity

[28]Paragraph .31 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A21 *Considerations specific to smaller entities.* Controls in smaller entities are likely to be less formal, and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions or potentially increase those risks through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities and inspection of available relevant documentation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 *Authorization and approval of significant transactions and arrangements (Ref: par. .15b).* Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance, or the entity's shareholders) for the entity to enter into specific transactions in accordance with predetermined criteria, whether or not judgmental. Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted. Examples of controls the entity may have established to authorize and approve significant transactions and arrangements with related parties or significant unusual transactions and arrangements outside the normal course of business include the following:

- Monitoring controls to identify such transactions and arrangements for authorization and approval
- Approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or, when applicable, shareholders

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Remaining Alert for Related Party Information When Reviewing Records or Documents

Records or Documents That the Auditor May Inspect (Ref: par. .17)

.A23 During the audit, the auditor may inspect records or documents that indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. Examples of those records or documents include the following:

- Third party confirmations obtained by the auditor (in addition to bank and legal confirmations)
- Entity income tax returns

- Information supplied by the entity to regulatory authorities
- Shareholder registers to identify the entity's principal shareholders
- Statements of conflicts of interest from management and those charged with governance
- Records of the entity's investments and those of its benefit plans
- Contracts and agreements with key management or those charged with governance
- Significant contracts and agreements not in the entity's ordinary course of business
- Specific invoices and correspondence from the entity's professional advisors
- Life insurance policies acquired by the entity
- Significant contracts renegotiated by the entity during the period
- Reports of the internal audit function
- Capital financing arrangements with entities other than financial institutions (for example, construction of a governmental entity facility associated with the issuance of debt by a related not-for-profit entity)
- Economic development arrangements for capital additions (for example, a governmental entity's use and eventual ownership of properties and facilities financed and operated by a company or another governmental entity)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A24 Additionally, the auditor may review the prior years' audit documentation for information about related party relationships and transactions. If applicable, the auditor may inquire of a predecessor auditor about the predecessor's knowledge of existing relationships and the extent of management involvement in material transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A25 *Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions.* An arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the following:

- The establishment of a business relationship through appropriate vehicles or structures
- The conduct of certain types of transactions under specific terms and conditions
- The provision of designated services or financial support

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include the following:

- Participation in unincorporated partnerships with other parties
- Agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business
- Guarantees and guarantor relationships

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification of Significant Unusual Transactions (Ref: par. .18)

.A26 Obtaining further information on significant unusual transactions enables the auditor to evaluate whether fraud risk factors, if any, are present and to identify the risks of material misstatement due to fraud. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A27 Examples of transactions that may be significant unusual transactions include the following:

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with less rigorous corporate governance structures, laws, or regulations
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements (for example, sales with a commitment to repurchase)
- Transactions under contracts whose terms are changed before expiration

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A28 *Understanding the nature of significant unusual transactions (Ref: par. .18a).* Inquiring into the nature of the significant unusual transactions involves obtaining an understanding of the business purpose of the transactions and the terms and conditions under which these have been entered into.[29] [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A29 *Inquiring into whether related parties could be involved (Ref: par. .18b).* A related party could be involved in a significant unusual transaction not only by directly influencing

[29]Paragraph .32*c* of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

the transaction by being a party to the transaction but also by indirectly influencing it through an intermediary. Such influence may indicate the presence of a fraud risk factor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Sharing Related Party Information With the Engagement Team (Ref: par. .19 and .25a)

.A30 Relevant related party information shared with the engagement team members may include the following:

- The nature of the related party relationships and transactions
- Significant or complex related party relationships or transactions that may be associated with significant risks, particularly transactions in which management or those charged with governance are financially involved

The exchange of information is most useful if made at an early stage of the audit. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A31 Section 600A addresses the communications that apply to group audits, particularly those that involve component auditors. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification and Assessment of the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

Fraud Risk Factors Associated With a Related Party With Dominant Influence (Ref: par. .21)

.A32 Related parties with the ability to exert control or significant influence may be in a position to exert dominant influence over the entity or its management. Consideration of such behavior is relevant when identifying and assessing the risks of material misstatement due to fraud, as further explained in paragraphs .A33–.A34. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A33 Domination of management by a single person or small group of persons without compensating controls is a fraud risk factor.[30] Indicators of dominant influence exerted by a related party include the following:

- The related party has vetoed significant business decisions taken by management or those charged with governance.
- Significant transactions are referred to the related party for final approval.
- Little or no debate occurs among management and those charged with governance regarding business proposals initiated by the related party.

[30]Paragraph .A76 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.

Dominant influence also may exist, in some cases, if the related party has played a leading role in founding the entity and continues to play a leading role in managing the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A34 In the presence of other risk factors, the existence of a related party with dominant influence may indicate significant risks of material misstatement due to fraud. For example

- an unusually high turnover of senior management or professional advisors may suggest unethical or fraudulent business practices that serve the related party's purposes.
- the use of business intermediaries for significant transactions for which there appears to be no clear business justification may suggest that the related party could have an interest in such transactions through control of such intermediaries for fraudulent purposes.

Evidence of the related party's excessive participation in, or preoccupation with, the selection of accounting policies or the determination of significant estimates may suggest the possibility of fraudulent financial reporting. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. .22)

.A35 The nature, timing, and extent of the further audit procedures that the auditor may select to respond to the assessed risks of material misstatement associated with related party relationships and transactions depend upon the nature of those risks and the circumstances of the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A36 Examples of substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk that management has not appropriately accounted for or disclosed specific related party transactions (whether due to fraud or error) include the following:

- Confirming the business purposes, specific terms, or amounts of the transactions with the related parties (this audit procedure may be less effective when the auditor judges that the entity is likely to influence the related parties in their responses to the auditor).
- Inspecting evidence in possession of the other party or parties to the transaction.
- Confirming or discussing significant information with intermediaries, such as banks, guarantors, agents, or attorneys, to obtain a better understanding of the transaction.

- Referring to financial publications, trade journals, credit agencies, and other information sources when there is reason to believe that unfamiliar customers, suppliers, or other business enterprises with which material amounts of business have been transacted may lack substance.
- With respect to material uncollected balances, guarantees, and other obligations, evaluating information about the financial capability of the other party or parties to the transaction. Such information may be obtained from audited financial statements, unaudited financial statements, income tax returns, and reports issued by regulatory agencies, taxing authorities, financial publications, or credit agencies.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A37 If the auditor has assessed a significant risk of material misstatement due to fraud as a result of the presence of a related party with dominant influence, the auditor may, in addition to the general requirements of section 240, perform audit procedures such as the following to obtain an understanding of the business relationships that such a related party may have established directly or indirectly with the entity and to determine the need for further appropriate substantive audit procedures:

- Inquiries of, and discussion with, management and those charged with governance
- Inquiries of the related party
- Inspection of significant contracts with the related party
- Appropriate background research, such as through the Internet or specific external business information databases
- Review of employee whistle-blowing reports when these are retained

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A38 Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone, regarding the risks of material misstatement associated with related party relationships and transactions. For example, when intragroup transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, authorized, recorded, processed, or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the requirement of section 330 to obtain sufficient appropriate audit evidence about the operating effectiveness of controls, the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions.[31] [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

Communicating Newly Identified Related Party Information to the Engagement Team (Ref: par. .25a)

.A39 Promptly communicating any newly identified related parties to the other members of the engagement team assists them in determining whether this information affects the results of, and conclusions drawn from, risk assessment procedures already performed, including whether the risks of material misstatement need to be reassessed. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Substantive Procedures Relating to Newly Identified Related Parties or Significant Related Party Transactions (Ref: par. .25d)

.A40 Examples of substantive audit procedures that the auditor may perform relating to newly identified related parties or significant related party transactions include the following:

- Making inquiries regarding the nature of the entity's relationships with the newly identified related parties, including inquiring of parties outside the entity who are presumed to have significant knowledge of the entity and its business, such as legal counsel, principal agents, major representatives, consultants, guarantors, or other close business partners.
- Conducting an analysis of accounting records for transactions with the newly identified related parties. Such an analysis may be facilitated using computer assisted audit techniques.
- Verifying the terms and conditions of the newly identified related party transactions and evaluating whether the transactions have been appropriately accounted for and disclosed.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Intentional Nondisclosure by Management (Ref: par. .25f)

.A41 The requirements and guidance in section 240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant when management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor also may consider whether it is necessary to reevaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.[32] [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

[31] Paragraph .08*b* of section 330. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

Identified Related Party Transactions Required To Be Disclosed or Determined to be a Significant Risk

Evaluating the Business Purpose (Ref: par. .26a(i))

.A42 In evaluating the business purpose of a related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk, the auditor may consider the following:

- Whether the transaction
  - — is overly complex (for example, it may involve multiple related parties within a consolidated group)
  - — has unusual terms of trade, such as unusual prices, interest rates, guarantees, and repayment terms
  - — lacks an apparent logical business reason for its occurrence
  - — involves previously unidentified related parties
  - — is processed in an unusual manner
- Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance
- Whether management is placing more emphasis on a particular accounting treatment rather than giving due regard to the economic substance of the transaction

If management's explanations are materially inconsistent with the terms of the related party transaction, the auditor is required to consider the reliability of management's explanations and representations on other significant matters.[33] [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A43 The auditor also may seek to understand the business purpose of such a transaction from the related party's perspective because this may help the auditor to better understand the economic substance of the transaction and why it was carried out. A business purpose from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Authorization and Approval of Significant Related Party Transactions (Ref: par. .26b)

.A44 Authorization and approval by management, those charged with governance, or, when applicable, the shareholders of related party transactions that are required to be

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[32] Paragraphs .22–.24 and .26 of section 580. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[33] Paragraph .10 of section 500, *Audit Evidence*. [Footnote renumbered by the issuance of SAS No. 135, May 2019. Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

disclosed in the financial statements or determined to be a significant risk may provide audit evidence that these have been duly considered at the appropriate levels within the entity, and that their terms and conditions have been appropriately reflected in the financial statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of rational explanations based on discussion with management or those charged with governance, may indicate risks of material misstatement due to fraud or error. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to the dominant influence of a related party. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A45 *Considerations specific to smaller entities.* A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity, the auditor may rely to a lesser degree on authorization and approval for audit evidence regarding the validity of related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk. Instead, the auditor may consider performing other audit procedures, such as inspecting relevant documents, confirming specific aspects of the transactions with relevant parties, or observing the owner-manager's involvement with the transactions. The discussion of management domination in paragraph .A33 and the fraud considerations discussed in paragraph .A8 provide further relevant guidance. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction (Ref: par. .27)

.A46 It will generally not be possible to determine whether a particular transaction would have taken place if the parties had not been related or, assuming it would have taken place, what the terms and manner of settlement would have been. Accordingly, it is difficult to substantiate representations that a transaction was consummated on terms equivalent to those that prevail in arm's length transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A47 Although audit evidence may be readily available regarding how the price of a related party transaction compares to that of a similar arm's length transaction, practical difficulties ordinarily limit the auditor's ability to obtain audit evidence that all other aspects of the transaction are equivalent to those of the arm's length transaction. For example, although the auditor may be able to confirm that a related party transaction has been conducted at a market price, it may be impracticable to confirm whether other terms and conditions of the transaction (such as credit terms, contingencies, and specific charges) are equivalent to those that would ordinarily be agreed between independent parties. Accordingly, there may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A48 The preparation and fair presentation of the financial statements requires management to substantiate an assertion included in financial statements that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, giving appropriate consideration to the difficulties described in paragraphs .A46–.A47. Management's support for the assertion may include the following:

- Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more unrelated parties
- Engaging an external specialist to determine a market value and confirm market terms and conditions for the transaction
- Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A49 Evaluating management's support for this assertion may involve one or more of the following:

- Considering the appropriateness of management's process for supporting the assertion
- Verifying the source of the internal or external data supporting the assertion and testing the data to determine their accuracy, completeness, and relevance

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A50 If the auditor believes that management's assertion is unsubstantiated or the auditor cannot obtain sufficient appropriate audit evidence to support the assertion, the auditor, in accordance with section 705, considers the implications for the audit, including the opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of the Accounting for, and Disclosure of, Identified Related Party Relationships and Transactions

Materiality Considerations in Evaluating Misstatements (Ref: par. .28)

.A51 Section 450, *Evaluation of Misstatements Identified During the Audit*, requires the auditor to consider both the size and nature of a misstatement and the particular circumstances of its occurrence when evaluating whether the misstatement is material.[34] The significance of the transaction to the financial statement users may not depend solely on the recorded amount of the transaction but also on other specific relevant factors, such as

[34]Paragraph .11*a* of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

the nature of the related party relationship. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of Related Party Disclosures (Ref: par. .28a)

.A52 Evaluating the related party disclosures means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if

a. the business purpose and the effects of the transactions on the financial statements are unclear or misstated.

b. key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Communication With Those Charged With Governance (Ref: par. .29)

.A53 Communicating significant findings or issues arising during the audit in connection with the entity's related parties helps the auditor establish a common understanding with those charged with governance of the nature and resolution of these matters.[35] Examples of significant related party findings or issues include the following:

- Nondisclosure (whether or not intentional) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware
- The identification of significant related party transactions that have not been appropriately authorized and approved, which may give rise to suspected fraud
- The identification of significant related party transactions that appear to lack a business purpose
- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions
- The inclusion of a statement in the financial statements that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction
- Noncompliance with applicable laws or regulations prohibiting or restricting specific types of related party transactions

[35] Paragraph .A10 of section 230 provides further guidance on the nature of significant findings or issues arising during the audit. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- Difficulties in identifying the party that ultimately controls the entity

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

AU-C Section 560

Subsequent Events and Subsequently Discovered Facts

Source: SAS No. 122; SAS No. 133; SAS No. 135; SAS No. 136.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. It also addresses a predecessor auditor's responsibilities for subsequent events and subsequently discovered facts when reissuing the auditor's report on previously issued financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period. (Ref: par. .A1)

Subsequent Events and Subsequently Discovered Facts

.02 Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

a. Those that provide evidence of conditions that existed at the date of the financial statements

b. Those that provide evidence of conditions that arose after the date of the financial statements

.03 Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, explain that the date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.[1] Accordingly, this section addresses the auditor's responsibilities relating to subsequent events occurring

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[1]Paragraph .A55 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .A119 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements. It also addresses the auditor's responsibilities relating to subsequently discovered facts that become known to the auditor after the date of the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.05 The objectives of the auditor are to

a. obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework and

b. respond appropriately to 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.

.06 The objective of a predecessor auditor who is requested to reissue a previously issued auditor's report on financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period is to perform specified procedures to determine whether the previously issued auditor's report is still appropriate before such report is reissued.

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Date of the auditor's report. The date that the auditor dates the report on the financial statements, in accordance with sections 700 or 703.[2] (Ref: par. .A14)

Date of the financial statements. The date of the end of the latest period covered by the financial statements.

Subsequent events. Events occurring between the date of the financial statements and the date of the auditor's report.

[2]Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Subsequently discovered facts. 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.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136]

.08 Reference to *audited financial statements* in this section means *the financial statements, together with the auditor's report thereon*.

Requirements

Subsequent Events

.09 The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: par. .A2–.A3)

.10 The auditor should perform the procedures required by paragraph .09 so that they cover the period from the date of the financial statements to the date of the auditor's report or as near as practicable thereto. The auditor should take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which should include the following: (Ref: par. .A4–.A5 and .A8–.A10)

a. Obtaining an understanding of any procedures that management has established to ensure that subsequent events are identified

b. Inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements (Ref: par. .A6)

c. Reading minutes, if any, of the meetings of the entity's owners, management, and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available (Ref: par. .A4 and .A7)

d. Reading the entity's latest subsequent interim financial statements, if any

.11 If, as a result of the procedures performed as required by paragraphs .09–.10, 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 the applicable financial reporting framework.

Subsequently Discovered Facts That Become Known to the Auditor Before the Report Release Date

.12 The auditor is not required to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if a subsequently discovered fact becomes known to the auditor before the report release date,[3] the auditor should

a. discuss the matter with management and, when appropriate, those charged with governance.

b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.[4]

.13 If management revises the financial statements, the auditor should perform the audit procedures necessary in the circumstances on the revision. The auditor also should either (Ref: par. .A11–.A16)

a. date the auditor's report as of a later date; extend the audit procedures referred to in paragraphs .09–.10 to the new date of the auditor's report on the revised financial statements; and request written representations from management as of the new date of the auditor's report, in accordance with the requirements of section 580, *Written Representations*, or

b. include an additional date in the auditor's report on the revised financial statements that is limited to the revision (that is, dual-date the auditor's report for that revision), thereby indicating that the auditor's procedures subsequent to the original date of the auditor's report are limited solely to the revision of the financial statements described in the relevant note to the financial statements. In this circumstance, the auditor should request written representations from management as of the additional date in the auditor's report about whether

    i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified.

    ii. any other events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements.

.14 If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, the auditor should modify the opinion (express a qualified opinion or an adverse opinion), as required by section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A17)

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[3]The term *report release date* is defined in paragraph .06 of section 230, *Audit Documentation*.

[4]There may be instances in which the auditor applies the relevant requirements in this section after the date of the auditor's report as described in section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, and section 945, *Auditor Involvement With Exempt Offering Documents*. [Footnote added, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

Subsequently Discovered Facts That Become Known to the Auditor After the Report Release Date

.15 If a subsequently discovered fact becomes known to the auditor after the report release date, the auditor should (Ref: par. .A18–.A20)

a. discuss the matter with management and, when appropriate, those charged with governance.

b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

.16 If management revises the financial statements, the auditor should

a. apply the requirements of paragraph .13.

b. if the audited financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the audited financial statements are not to be relied upon. If management does not take the necessary steps, the auditor should apply the requirements of paragraph .18. (Ref: par. .A21–.A22)

c. if the auditor's opinion on the revised financial statements differs from the opinion the auditor previously expressed, disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*:

   i. The date of the auditor's previous report

   ii. The type of opinion previously expressed

   iii. The substantive reasons for the different opinion

   iv. That the auditor's opinion on the revised financial statements is different from the auditor's previous opinion

.17 If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, then

a. if the audited financial statements have not been made available to third parties, the auditor should notify management and those charged with governance—unless all of those charged with governance are involved in managing the entity[5]—not to make the audited financial statements available to third parties before the necessary revisions have been made and a new auditor's report on the revised financial statements has been provided. If the audited financial statements are, nevertheless, subsequently

[5]Paragraph .14 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

made available to third parties without the necessary revisions, the auditor should apply the requirements of paragraph .17*b*.

b. if the audited financial statements have been made available to third parties, the auditor should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the audited financial statements is informed of the situation, including that the audited financial statements are not to be relied upon. If management does not take the necessary steps, the auditor should apply the requirements of paragraph .18. (Ref: par. .A21–.A22)

.18 If management does not take the necessary steps to ensure that anyone in receipt of the audited financial statements is informed of the situation, as provided by paragraphs .16*b* or .17*b*, the auditor should notify management and those charged with governance—unless all of those charged with governance are involved in managing the entity[6]—that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take the necessary steps, the auditor should take appropriate action to seek to prevent reliance on the auditor's report. (Ref: par. .A23–.A26)

Predecessor Auditor's Reissuance of the Auditor's Report in Comparative Financial Statements (Ref: par. .A27–.A28)

Predecessor Auditor's Report Reissued (Ref: par. .A29–.A30)

.19 Before reissuing a previously issued auditor's report on financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period, the predecessor auditor should perform the following procedures to determine whether the previously issued auditor's report is still appropriate:

a. Read the financial statements of the subsequent period to be presented on a comparative basis

b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis

c. Inquire of, and request written representations from, management of the former client, at or near the date of reissuance, about whether

   i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified

   ii. any events have occurred subsequent to the date of the latest prior period financial statements reported on by the predecessor auditor that would require adjustment to, or disclosure in, those financial statements

[6]Paragraph .14 of section 260. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor

.20 If, in performing the procedures in paragraph .19, a subsequently discovered fact becomes known to the predecessor auditor, then

a. the predecessor auditor should apply the requirements of paragraph .15.

b. if management revises the financial statements and the predecessor auditor plans to issue a new auditor's report on the revised financial statements, the predecessor auditor should apply the requirements of paragraph .16.

c. if management revises the financial statements and the predecessor auditor does not plan to issue a new auditor's report on the revised financial statements, or if management does not revise the financial statements in circumstances when the predecessor auditor believes they need to be revised, the predecessor auditor should assess the steps taken by management, as required by paragraph .17*b*.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 When audited financial statements are included in other documents subsequent to their issuance, the auditor may have additional responsibilities to consider, such as legal or regulatory requirements involving private placement offerings, exempt public offerings (including offerings pursuant to Securities and Exchange Commission [SEC] Rule 144A), or other offerings of securities to the public in jurisdictions outside the United States. Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, may be applied, adapted as necessary in the circumstances, to such other documents. Section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, addresses the auditor's responsibilities in connection with financial statements of a nonissuer included in a registration statement filed with the SEC under the Securities Act of 1933, as amended. Section 945, *Auditor Involvement With Exempt Offering Documents*, addresses the auditor's responsibilities when an auditor is involved with an exempt offering document. [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133. Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

Subsequent Events (Ref: par. .09–.11)

.A2 The period between the date of the financial statements and the date of the auditor's report may vary from a relatively short period to one or more months. Some phases of the audit will be performed during this period, whereas other phases will be substantially completed on or before the date of the financial statements. As an audit approaches completion, the auditor is not expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. New information, however, may be inconsistent with the audit evidence obtained, in which case the auditor is required to determine what modifications or additions to audit procedures are necessary to resolve the matter and consider the effect of the matter, if any, on other aspects of the audit.[7]

.A3 Depending on the auditor's risk assessment, the audit procedures required by paragraphs .09–.10 may include procedures necessary to obtain sufficient appropriate audit evidence involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor's report. The audit procedures required by paragraphs .09–.10 are in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for account balances as of the date of the financial statements, such as cut-off procedures or procedures regarding subsequent receipts of accounts receivable).

.A4 Paragraph .10 stipulates certain audit procedures that the auditor is required to perform pursuant to paragraph .09. However, the subsequent events procedures that the auditor performs may depend on the information that is available and, in particular, the manner in which the accounting records have been maintained and the extent to which information has been prepared since the date of the financial statements. When interim financial statements (whether for internal or external purposes) or minutes of meetings of management or those charged with governance have not been prepared, relevant audit procedures may take the form of inspection of available books and records.

.A5 In addition to the audit procedures required by paragraphs .09–.10, the auditor may consider it necessary and appropriate to read the entity's latest available budgets, cash flow forecasts, and other related management reports for periods after the date of the financial statements. Paragraphs .A6–.A10 provide guidance on additional matters that the auditor may consider in the course of performing subsequent events procedures.

Inquiry (Ref: par. .10b)

.A6 In inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire about the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

- Whether new commitments, borrowings, or guarantees have been entered into
- Whether sales or acquisitions of assets have occurred or are planned

[7]Paragraph .10 of section 500, *Audit Evidence*. [Footnote renumbered by the issuance of SAS No. 133, June 2018. Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned
- Whether any assets have been appropriated by the government or destroyed (for example, by fire or flood)
- Whether there have been any developments regarding contingencies
- Whether any unusual accounting adjustments have been made or are contemplated
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements
- Whether any events have occurred that are relevant to the recoverability of assets
- Whether there have been any changes in the entity's related parties
- Whether there have been any significant new related party transactions
- Whether the entity has entered into any significant unusual transactions

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

*Reading Minutes (Ref: **par. .10c**)*

Considerations Specific to Governmental Entities

.A7 In audits of governmental entities, the auditor may, in performing the requirement in paragraph .10*c*, read the official records of relevant proceedings of the legislative or governing body, or other relevant regulatory or oversight body, and inquire about matters addressed in proceedings for which official records are not yet available.

Inquiries of Legal Counsel

.A8 Section 501, *Audit Evidence—Specific Considerations for Selected Items*, addresses the auditor's responsibility to seek direct communication with the entity's legal counsel concerning litigation, claims, and assessments through the date of the auditor's report.

Written Representations

.A9 Section 580 requires the auditor to request that management and, when appropriate, those charged with governance provide written representations as of the date of the auditor's report that all events occurring subsequent to the date of the financial statements, and for which the applicable financial reporting framework requires adjustment or disclosure, have been adjusted or disclosed.[8] The auditor may consider whether written representations covering particular subsequent events or significant matters disclosed to the auditor in the performance of the audit procedures required by paragraphs .09–.10 may be necessary to support other audit evidence to obtain sufficient appropriate audit evidence.

.A10 The applicable financial reporting framework may require management to evaluate subsequent events through the date the financial statements are issued or available to be issued and to disclose the date through which subsequent events were evaluated in the financial statements. In most cases, this will result in the date that management discloses as the date through which management has evaluated subsequent events being the same date as the auditor's report. This is because section 700 or section 703 requires the auditor's report to 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; that all the statements that comprise the financial statements, including related notes, have been prepared; and that management has asserted that they have taken responsibility for those financial statements.[9] Also, the auditor is concerned with subsequent events that require adjustment of, or disclosure in, the financial statements through the date of the auditor's report or as near as practicable thereto. Therefore, management's representations concerning events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure are required to be made as of the date of the auditor's report on the financial statements.[10] To align the date disclosed by management in the financial statements, the representation letter date, and the auditor's report date, the auditor may discuss the dating requirements with management and may also include, in the terms of the audit engagement,[11] that management will not date the subsequent event disclosure earlier than the date of the representation letter (also the date of the auditor's report). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Subsequently Discovered Facts That Become Known to the Auditor Before the Report Release Date (Ref: par. .12–.14)

Dating the Auditor's Report on the Revised Financial Statements (Ref: par. .13)

.A11 The auditor has two methods available for dating the auditor's report when the financial statements are revised after the original date of the auditor's report. The auditor may include an additional date limited to the revision (that is, dual-date the auditor's report for that revision) or date the auditor's report as of a later date. In the former instance, the auditor's responsibility for events occurring subsequent to the original date of the

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[8]Paragraph .18 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

[9]Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[10]Paragraph .20 of section 580. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

[11]Paragraph .A24 of section 210A, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

auditor's report is limited to the specific event described in the relevant note to the financial statements. In the latter instance, the auditor's responsibility for subsequent events extends to the new date of the auditor's report on the revised financial statements.

.A12 Generally, when the revision of the financial statements is specifically limited to the effects of the specific event described in the relevant note to the financial statements, the auditor may decide to limit the audit procedures to that revision, as provided by paragraph .13*b*. Even when the financial statements are revised and disclosure of the revision is made, the auditor is not precluded from extending the audit procedures referred to in paragraphs .09–.10 to the new date of the auditor's report on the revised financial statements, as provided by paragraph .13*a*.

.A13 When, in the circumstances described in paragraph .13*b*, the auditor includes an additional date limited to the revision (a dual date), the original date of the auditor's report on the financial statements prior to their subsequent revision by management remains unchanged because this date informs the reader about when the auditor obtained sufficient appropriate audit evidence with respect to those financial statements prior to their subsequent revision. However, an additional date is included in the auditor's report to inform users that the auditor's procedures subsequent to the original date of the auditor's report were limited to the subsequent revision of the financial statements. The following is an illustration of such wording:

(Date of auditor's report), except as to note Y, which is as of (date of completion of audit procedures limited to revision described in note Y).

.A14 As discussed in paragraph .A10, section 700 or section 703, as applicable, requires the auditor's report to 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.[12] When management revises the financial statements and the auditor reports on the revised financial statements, the new date (or the dual date) included in the auditor's report cannot be earlier than the date on which the auditor carried out the audit procedures necessary in the circumstances on the revision, including that the documentation has been reviewed and management has prepared and asserted that they have taken responsibility for the revised financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Updated Written Representations

.A15 Section 580 requires the date of the written representations to be as of the date of the auditor's report on the financial statements.[13] If management revises the financial statements and, in accordance with paragraph .13*a*, the auditor dates the auditor's report on the revised financial statements as of a later date, written representations from

[12] Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[13] Paragraph .20 of section 580. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

management are required as of the later date to comply with section 580. The auditor may request management to provide a new representation letter or may agree with management on a form of written representations that update the written representations previously provided by addressing whether there are any changes to such written representations and, if so, what they are. An updated written representation letter may be in the form of the representations required by paragraph .13*b* when the auditor dual-dates the auditor's report for the revision.

Unaudited Events

.A16 To prevent the financial statements from being misleading, management may revise the financial statements by disclosing an event that arose after the original date of the auditor's report. When such event is included in a separate financial statement note that is labeled as unaudited (for example, when the event is captioned "Event (Unaudited) Subsequent to the Date of the Independent Auditor's Report"), the auditor is not required to perform any procedures on the revision, and the auditor's report carries the original date of the auditor's report.

Considerations Specific to Governmental Entities (Ref: par. .14)

.A17 In audits of governmental entities in which management does not revise the financial statements, the actions taken in accordance with paragraph .14 may also include reporting separately to the legislative or governing body, or other relevant regulatory or oversight body, on the implications of the subsequent event for the financial statements and the auditor's report and, if applicable, for the entity's internal control over financial reporting and compliance with law or regulation.

Subsequently Discovered Facts That Become Known to the Auditor After the Report Release Date (Ref: par. .15–.18)

Auditor's Responsibility After the Report Release Date (Ref: par. .15)

.A18 New information may come to the auditor's attention that, had such information been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report. When such information becomes known to the auditor after the report release date, the requirements in paragraphs .15–.18 apply, even if the auditor has withdrawn or been discharged.

.A19 Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, in determining whether the financial statements need revision, as required by paragraph .15*b*, the auditor may consider, in addition to the requirements of the applicable financial reporting framework, whether the auditor believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of audited financial statements for a subsequent period, the time elapsed since the financial statements were issued and the auditor's report released, and any legal implications.

.A20 Section 708, *Consistency of Financial Statements*, addresses the auditor's evaluation of the consistency of the financial statements, including changes to previously issued financial statements, and the effect of that evaluation on the auditor's report.

Revision of Financial Statements by Management (Ref: par. .16b and .17b)

.A21 The steps taken by management to ensure that anyone in receipt of the audited financial statements is informed of the situation, including that the audited financial statements are not to be relied upon, depend on the circumstances. Management's steps may include the following:

- Notification to anyone who is known to be relying or who is likely to rely on the financial statements and the auditor's report that they are not to be relied upon and that revised financial statements, together with a new auditor's report, will be issued. This may be necessary when the issuance of revised financial statements and a new auditor's report is not imminent.
- Issuing, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issuing the subsequent period's financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period's audited financial statements is imminent.

Considerations Specific to Governmental Entities

.A22 For audits performed under *Government Auditing Standards*, additional requirements exist, such as those pertaining to the evaluation of the timeliness and appropriateness of management's disclosure and actions to determine and correct misstatements in previously issued financial statements, reporting on the revised financial statements, and reporting directly to appropriate officials when management does not take the necessary steps.

Auditor Action to Seek to Prevent Reliance on the Auditor's Report (Ref: par. .18)

.A23 If management made the audited financial statements available to third parties despite the auditor's notification not to do so, or if the auditor believes that management or those charged with governance have failed to take the necessary steps to prevent reliance on the auditor's report on the previously issued audited financial statements despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

.A24 The actions that the auditor may take to seek to prevent reliance on the auditor's report may depend upon the degree of certainty of the auditor's knowledge that persons or entities exist who are currently relying or who will rely on the audited financial statements, and who would attach importance to the information, and the auditor's ability as a practical matter to communicate with them. In addition to seeking legal advice, the auditor may consider taking the following steps to the extent applicable:

- Notify management and those charged with governance that the auditor's report is not to be relied upon.
- Notify regulatory agencies having jurisdiction over the entity that the auditor's report is not to be relied upon, including a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.
- Notify anyone known to the auditor to be relying on the financial statements that the auditor's report is not to be relied upon. In some instances, it will not be practicable for the auditor to give appropriate individual notification to stockholders or investors at large whose identities are unknown to the auditor; notification to a regulatory agency having jurisdiction over the entity will usually be the only practical means for the auditor to provide appropriate disclosure, together with a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

.A25 Depending on the circumstances, if the auditor is able to determine that the financial statements need revision, the auditor's notification to anyone in receipt of the audited financial statements may, if permitted by law, regulation, and relevant ethical requirements,

- include a description of the nature of the matter and of its effect on the financial statements, avoiding comments concerning the conduct or motives of any person.
- describe the effect that the matter would have had on the auditor's report if it had been known to the auditor at the date of the report and had not been reflected in the financial statements.

.A26 If the auditor was not able to determine whether the financial statements need revision, the notification to anyone in receipt of the audited financial statements may indicate that information became known to the auditor and that, if the information is true, the auditor believes that the auditor's report is not to be relied upon. The specific matter need not be detailed in the notification.

Predecessor Auditor's Reissuance of the Auditor's Report in Comparative Financial Statements (Ref: par. .19–.20)

.A27 An auditor may be requested by management or those charged with governance to furnish additional copies of the auditor's report after the report release date. Providing additional copies of the auditor's report is not a report reissuance. In such cases, the auditor has no responsibility to make further investigation or inquiry about events that may have occurred during the period between the date of the auditor's report and the date of the release of the additional copies.

.A28 Additional responsibilities relating to the reissuance of a previously issued auditor's report in connection with financial statements of a nonissuer included in a registration statement filed with the SEC under the Securities Act of 1933, as discussed in paragraph .A1, are addressed in section 925.

Predecessor Auditor's Report Reissued

.A29 A predecessor auditor may be requested to reissue the auditor's report by a former client when prior period financial statements audited by the predecessor auditor are to be presented on a comparative basis with audited financial statements of a subsequent period. A predecessor auditor's knowledge of the current affairs of the former client is limited in the absence of a continuing relationship. Accordingly, a predecessor auditor may be in a position to reissue the report if the predecessor auditor is able to make satisfactory arrangements with the former client to perform this service and if the predecessor auditor complies with paragraph .19 to determine whether the previous auditor's report is still appropriate. A predecessor auditor is not required to reissue the auditor's report. Either the current form or manner of presentation of the financial statements of the prior period or one or more events might make a predecessor auditor's previous report inappropriate.

.A30 Section 700 and section 703, as applicable, address the auditor's responsibilities when the auditor is engaged to audit and report on a revision to prior period financial statements audited by the predecessor auditor.[14] It also addresses the auditor's responsibilities when the predecessor auditor's report will not be presented.[15] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[14] Paragraph .A75 of section 700, and paragraph .A129 of section 703, as applicable. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

[15] Paragraph .57 of section 700, and paragraph .93 of section 703, as applicable. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

AU-C Section 570

The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

(Supersedes SAS No. 126.)

Source: SAS No. 132; SAS No. 134; SAS No. 136.

Effective for audits of financial statements for periods ending on or after December 15, 2017, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities in the audit of financial statements relating to the entity's ability to continue as a going concern and the implications for the auditor's report. This section applies to all audits of a complete set of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework.[1]

.02 Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for a reasonable period of time. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate. (Ref: par. .A1–.A2)

.03 Special purpose financial statements[2] may or may not be prepared in accordance with an applicable financial reporting framework for which the going concern basis of accounting is relevant. As a result, when the going concern basis of accounting is not relevant, the requirement of this section to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting do not apply. However, irrespective of whether the going concern basis of accounting is relevant in the preparation of special purpose financial statements, the requirements of this section apply regarding the auditor's responsibilities to perform the following:

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[1]*General purpose* and *special purpose frameworks* are defined in section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* , respectively.

[2]Section 800 addresses audits of a complete set of financial statements prepared in accordance with special purpose frameworks.

a. Conclude, based on the audit evidence obtained, whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time

b. Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time

.04 The auditor's responsibilities under this section apply even if the applicable financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific evaluation of the entity's ability to continue as a going concern.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

.05 Some financial reporting frameworks explicitly require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time and provide disclosures related to the entity's ability to continue as a going concern. For example, FASB *Accounting Standards Codification*® (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).[3] Similarly, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards,* requires financial statement preparers to evaluate whether there is substantial doubt about a governmental entity's ability to continue as a going concern for 12 months beyond the date of the financial statements. GASB Statement No. 56 further requires that, if information is currently known to the governmental entity that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.[4] Law or regulation may also set forth requirements regarding management's responsibility to evaluate the entity's ability to continue as a going concern for a defined period of time and related financial statement disclosures. (Ref: par. .A3)

.06 Management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of conditions or events. The following factors are relevant to that judgment:

a. The degree of uncertainty associated with the outcome of a condition or event increases significantly the further into the future a condition or event or the outcome

[3] "Pending Content" in FASB *Accounting Standards Codification* (ASC) 205-40-50-1.

[4] Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

occurs. For that reason, most financial reporting frameworks that require an explicit management evaluation specify the period for which management is required to take into account all available information.

b. The size and complexity of the entity, the nature and condition of its business, and the degree to which it is affected by external factors affect the judgment regarding the outcome of conditions or events.

c. Any judgment about the future is based on conditions or events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued, when applicable). Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made. (Ref: par. .A4–.A5)

When Management Is Not Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

.07 In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, when the going concern basis of accounting is a fundamental principle in the preparation of financial statements, as discussed in paragraphs .02–.03, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

Inherent Limitations in Evaluating the Entity's Ability to Continue as a Going Concern

.08 The potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The auditor cannot predict such future conditions or events. Accordingly, the absence of any reference to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in an auditor's report cannot be viewed as a guarantee of the entity's ability to continue as a going concern for a reasonable period of time.

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2017.

Objectives

.10 The objectives of the auditor are as follows:

a. To obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements

b. To conclude, based on the audit evidence obtained, whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists

c. To evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time

d. To report in accordance with this section

Definition

.11 For purposes of this section, the following term has the meaning attributed as follows:

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. .A6)

Requirements

Risk Assessment Procedures and Related Activities

Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern

.12 When performing risk assessment procedures as required by section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,[5] the auditor should consider whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions or events exist: (Ref: par .A7–.A16)

a. If such an evaluation has been performed, the auditor should discuss the evaluation with management and determine whether management has identified conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time and, if so, understand management's plans to address them.

b. If such an evaluation has not yet been performed, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire of management whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

[5]Paragraph .05 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.*

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events

.13 The auditor should remain alert throughout the audit for audit evidence of conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A17)

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation

.14 The auditor's evaluation should

a. address management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A18–.A24)

b. cover the same period as that used by management in its evaluation as required by the applicable financial reporting framework. (Ref: par. .A19)

c. include consideration of whether management's evaluation includes all relevant information of which the auditor is aware as a result of the audit.

Period Beyond Management's Evaluation

.15 The auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern. (Ref: par. .A23, .A25–.A27)

Additional Audit Procedures When Events or Conditions Are Identified

.16 The auditor should obtain sufficient appropriate audit evidence to determine whether conditions and events identified, considered in the aggregate, raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time by performing additional audit procedures, including consideration of mitigating factors. These procedures should include the following: (Ref: par. .A28)

a. Requesting management to make an evaluation when management has not yet performed an evaluation

b. Evaluating management's plans in relation to its going concern evaluation, with regard to whether it is probable that (Ref: par. .A29)

    i. management's plans can be effectively implemented and

    ii. the plans would mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time

c. When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in evaluating management's plans, (Ref: par. .A30–.A31)

i. evaluating the reliability of the underlying data generated to prepare the forecast and

ii. determining whether there is adequate support for the assumptions underlying the forecast, which includes considering contradictory audit evidence

d. Considering whether any additional facts or information have become available since the date on which management made its evaluation

Financial Support by Third Parties or the Entity's Owner-Manager

.17 When management's plans include financial support by third parties or the entity's owner-manager (hereinafter referred to as "supporting parties") and such support is necessary in supporting management's assertions about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain sufficient appropriate audit evidence about the following:

a. The intent of such supporting parties to provide the necessary financial support, including written evidence of such intent, and (Ref: par. .A32–.A37)

b. The ability of such supporting parties to provide the necessary financial support (Ref: par. .A24, .A38)

The failure to obtain the written evidence required by item (*a*) constitutes a lack of sufficient appropriate audit evidence regarding the intent of the supporting parties to provide financial support. Therefore, the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A32–.A34)

Written Representations

.18 If the auditor believes, before consideration of management's plans pursuant to paragraph .16, that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should request the following written representations from management: (Ref: par. .A39–.A40)

a. A description of management's plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the probability that those plans can be effectively implemented

b. That the financial statements disclose all the matters of which management is aware that are relevant to the entity's ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management's plans

Auditor Conclusions

Use of the Going Concern Basis of Accounting

.19 The auditor should evaluate whether sufficient appropriate audit evidence has been obtained and conclude on the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

.20 Based on the audit evidence obtained, the auditor should conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.21 If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time, the auditor should evaluate the adequacy of the financial statement disclosures as required by the applicable financial reporting framework. (Ref: par. .A41–.A44)

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans

.22 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans, the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. (Ref: par. .A45–.A47)

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting Is Inappropriate

.23 If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor should express an adverse opinion. (Ref: par. .A48–.A50)

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified

.24 If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor's report[6] with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following: (Ref: par. .A53–.A58)

a. Draws attention to the note in the financial statements that discloses
   i. the conditions or events identified and management's plans that deal with these conditions or events and
   ii. that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
b. States that the auditor's opinion is not modified with respect to the matter

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.25 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Adequate Disclosure About an Entity's Ability to Continue as a Going Concern Is Not Made in the Financial Statements

.26 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should do the following:

a. Express a qualified opinion or adverse opinion, as appropriate, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.
b. In the "Basis for Qualified (Adverse) Opinion" section of the auditor's report, state that
   i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter or
   ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[6] [Footnote deleted by the issuance of SAS No. 134, May 2019.]

Management Unwilling to Perform or Extend Its Evaluation

.27 If management is unwilling to perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework when requested to do so by the auditor, the auditor should consider the implications for the auditor's report. (Ref: par. .A59)

Communication With Those Charged With Governance

.28 Unless all those charged with governance are involved in managing the entity,[7] the auditor should communicate with those charged with governance regarding conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Such communication with those charged with governance should include the following:

a. Whether the conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time constitute substantial doubt

b. The auditor's consideration of management's plans

c. Whether management's use of the going concern basis of accounting, when relevant, is appropriate in the preparation of the financial statements

d. The adequacy of related disclosures in the financial statements

e. The implications for the auditor's report

Comparative Presentations

.29 If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis and that doubt has been removed in the current period, the going concern section included in the auditor's report on the financial statements of the prior period should not be repeated. (Ref: par. .A60–.A61) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Eliminating a Going Concern Section From a Reissued Report

.30 Management may request that the auditor reissue an auditor's report and eliminate a "Going Concern" section contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going concern status of the entity by doing the following:

a. Performing audit procedures related to the events or transactions that prompted the request to reissue the report without the "Going Concern" section

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[7]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

b. Performing the procedures listed in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or near the date of reissuance, including procedures to evaluate the adequacy of the proposed disclosures regarding management's plans to mitigate the conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time[8]

c. Considering the matters described in paragraphs .16–.18 of this section based on the conditions or circumstances at the date of reissuance

d. Considering the implications for the auditor's report in accordance with section 560[9] (Ref: par. .A62–.A63)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Delay in the Issuance of Financial Statements

.31 If there is significant delay in the expected issuance of the financial statements by management or those charged with governance, the auditor should inquire about the reasons for the delay. If the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, the auditor should perform additional audit procedures as necessary, as described in paragraph .16, as well as consider the effect on the auditor's conclusion regarding the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, as described in paragraph .21.

Documentation

.32 If conditions or events are identified that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans, the auditor should document the following: (Ref: par. .A63)

a. The conditions or events that led the auditor to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, if applicable.

c. The audit procedures performed to evaluate the significant elements of management's plans and evidence obtained, if applicable.

d. The auditor's conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains

[8] Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[9] Paragraph .13 of section 560.

or is alleviated. If substantial doubt remains, the auditor should also document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor should also document the auditor's conclusion regarding the need for, and, if applicable, the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt and management's plans that alleviated the substantial doubt.

e. The auditor's conclusion with respect to the effects on the auditor's report.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 The applicable financial reporting framework might contain explicit requirements regarding when the liquidation basis of accounting is appropriate. For example, FASB ASC requires that if and when an entity's liquidation becomes imminent financial statements should be prepared under the liquidation basis of accounting.[10] Accordingly, this section does not apply to an audit of a complete set of general purpose financial statements prepared under the liquidation basis of accounting.

Considerations Specific to Governmental Entities

.A2 Management's use of the going concern basis of accounting is also relevant to financial statements of governmental entities. For example, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, addresses the issue of the ability of governmental entities to continue as a going concern for 12 months beyond the financial statement date, and requires consideration of information known to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months).[11] Going concern indicators may arise in, but are not limited to, situations in which governmental entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Conditions or events that raise substantial doubt about a governmental entity's ability to continue as a going concern for a reasonable period of time may include situations in which the governmental entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the governmental entity.

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[10] FASB ASC 205-30.

[11] Paragraphs 16–19 of GASB Statement No. 56.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

*When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework (Ref: **par. .05–.06**)*

.A3 FASB ASC defines *substantial doubt about an entity's ability to continue as a going concern* as follows:

Substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The term *probable* is used consistently with its use in topic 450 on contingencies.[12]

Other financial reporting frameworks may use different terms that are similar to the concept of substantial doubt. For example, International Financial Reporting Standards (IFRS) use the terms *material uncertainty* and *significant doubt*. Also, other financial reporting frameworks may not use *probable* as their threshold. For example, IFRS uses "may cast significant doubt on the entity's ability to continue as a going concern."[13] This section uses the terminology of FASB ASC and the GASB statements; if an audit is performed on financial statements prepared under another financial reporting framework, the requirements and application material may need to be adapted as necessary.

.A4 In addition to the factors in paragraph .06, FASB ASC requires management to consider quantitative and qualitative information about the following conditions and events:[14]

a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)

b. The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements)

c. The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued

d. The other conditions and events, when considered in conjunction with the preceding items, that may adversely affect the entity's ability to meet its obligations within one year after the date the financial statements are issued. See paragraph .A7 for examples of those conditions and events.

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[12] "Pending Content" in FASB ASC 205-40-20.

[13] See paragraph 25 of International Accounting Standard (IAS) 1, *Presentation of Financial Statements*.

[14] "Pending Content" in FASB ASC 205-40-50-5.

.A5 As explained by FASB, *reasonably knowable* means that an entity should make a reasonable effort to identify conditions and events that it may not readily know but would be able to identify without undue cost and effort.[15]

Definition (Ref: par. .11)

.A6 Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

a. *FASB.* Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).[16]

b. *GASB.* 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.[17]

c. *International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.[18]

Risk Assessment Procedures and Related Activities

Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern (Ref: par. .12)

.A7 The following list includes examples of adverse conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. This list is not all-inclusive. The existence of one or more of these conditions or events does not establish that there is substantial doubt about the entity's ability to continue as a going concern. Similarly, the absence of these conditions or events does not establish that there is no substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Determining whether there is substantial doubt depends on an assessment of relevant conditions and events, in the aggregate, that are known and reasonably knowable at the date that the financial statements are issued (or at the date the financial statements are available to be issued, when applicable). An entity should weigh the likelihood and magnitude of the potential effects of the relevant conditions and events and consider their anticipated timing.[19]

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[15] See paragraph BC26 of the "Background Information and Basis for Conclusions" section of "Pending Content" in FASB ASC 205-40.

[16] "Pending Content" in FASB ASC 205-40-50-1.

[17] Paragraph 16 of GASB Statement No. 56.

[18] Paragraph 26 of IAS 1.

[19] "Pending Content" in FASB ASC 205-40-55-2.

a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios

b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets

c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations

d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

.A8 The significance of such events or conditions can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable[20] that the plan will be effectively implemented within one year after the date that the financial statements are issued.[21]

a. Plans to dispose of an asset or business
   i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loan or similar agreements, or encumbrances against the asset or business
   ii. Marketability of the asset or business that management plans to sell
   iii. Possible direct or indirect effects of disposal of the asset or business

b. Plans to borrow money or restructure debt
   i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
   ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity

[20] The FASB ASC master glossary defines *probable* as "the future event or events are likely to occur."

[21] "Pending Content" in FASB ASC 205-40-55-3.

iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral

c. Plans to reduce or delay expenditures

  i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets

  ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures

d. Plans to increase ownership equity

  i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital

  ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

Considerations Specific to Governmental Entities

.A9 The GASB statements also include the following examples of indicators that there may be substantial doubt about a governmental entity's ability to continue as a going concern:[22]

a. *Negative trends.* For example, recurring periods in which expenses or expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios

b. *Other indications of possible financial difficulties*. For example, default on bonds, loans, or similar agreements; proximity to debt and tax limitations; denial of usual trade credit from suppliers; restructuring of debt (other than refundings); noncompliance with statutory capital or reserve requirements; or the need to seek new sources or methods of financing or to dispose of substantial assets

c. *Internal matters*. For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations

d. *External matters*. For example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood

.A10 The indicators listed in paragraph .A9 may be mitigated by other factors. For example, taxing power and borrowing capabilities together with the constant demand

[22] Paragraph 17 of GASB Statement No. 56.

for the provision of public services are factors that may diminish the possibility that a governmental entity would be unable to continue as a going concern.[23]

Other Considerations

.A11 The risk assessment procedures required by paragraph .12 are intended to assist the auditor in determining whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is likely to be an important issue in planning and performing the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans for addressing any potential going concern matters identified.

.A12 In the absence of guidance provided by the applicable financial reporting framework that illustrates adverse conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time or plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, the auditor may consider the guidance in paragraphs .A7–.A10.

.A13 As discussed in paragraph .A7, FASB ASC contains guidance for determining whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time. Other financial reporting frameworks may contain other relevant guidance.

.A14 If management is preparing interim financial statements, FASB ASC requires management to perform a going concern evaluation for the interim periods.[24] As a result, the auditor may consider management's interim evaluation(s) of whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern in completing the risk assessment procedures in paragraph .12.

Considerations Specific to Smaller, Less Complex Entities

.A15 The size of an entity may affect its ability to withstand adverse conditions. Smaller, less complex entities may be able to respond quickly to exploit opportunities but may lack reserves to sustain operations.

.A16 Conditions of particular relevance to smaller entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise, or other legal agreement.

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events (Ref: par. .13)

.A17 Section 315A requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence that

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[23] Paragraph 18 of GASB Statement No. 56.

[24] "Pending Content" in FASB ASC 205-40-50-1.

affects the auditor's assessment of risk is obtained during the course of the audit.[25] If conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time are identified after the auditor's initial risk assessments are made, in addition to performing the procedures in paragraph .16 of this section, the auditor's assessment of the risks of material misstatement may need to be revised. The existence of such conditions or events may also affect the nature, timing, and extent of the auditor's further procedures in response to the assessed risks. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, establishes requirements and provides guidance on this issue.

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation (Ref: par. .14)

.A18 Management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is an important consideration with respect to the auditor's conclusion on management's use of the going concern basis of accounting and whether substantial doubt exists.

.A19 If management is not required by the applicable financial reporting framework to make an evaluation about whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, then the period that the auditor's evaluation covers is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable), as discussed in paragraph .11.

.A20 It is not the auditor's responsibility to rectify the lack of analysis by management to support its evaluation. In some circumstances, however, the auditor may be able to conclude whether substantial doubt exists in the circumstances despite the lack of detailed analysis by management. For example, when a history of profitable operations and a ready access to financial resources exists, management may make its evaluation without a detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's evaluation may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether there is substantial doubt in the circumstances. However, in situations in which management is required by the applicable financial reporting framework to make an evaluation about the entity's ability to continue as a going concern for a reasonable period of time, a lack of a detailed analysis when needed may be an indicator of a deficiency in internal control. An auditor's evaluation is required to determine whether this constitutes a significant deficiency or material weakness, in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

.A21 In other circumstances, evaluating management's evaluation of whether there is substantial doubt, as required by paragraph .14, may include an evaluation of the process

[25] Paragraph .32 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.*

management followed to make its evaluation, the assumptions on which the evaluation is based, management's plans, and whether management's plans are feasible in the circumstances to alleviate substantial doubt.

.A22 For financial reporting frameworks that require the entity to perform an evaluation about whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, for example, FASB ASC and the GASB statements,[26] the auditor's conclusions might be primarily based on the auditor's procedures performed to evaluate management's compliance with the applicable financial reporting framework.

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .14)

.A23 In many cases, management of smaller entities may not have prepared a detailed evaluation of whether there is substantial doubt, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this section, the auditor is required to evaluate management's evaluation of whether there is substantial doubt. For smaller entities, it may be appropriate to discuss the medium and long-term financing of the entity with management.

.A24 Financial support by owner-managers is often important to smaller entities' ability to continue as a going concern. When a smaller entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a smaller entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner-manager supporting a loan for the entity by providing a guarantee with the owner-manager's personal assets as collateral. See paragraphs .A32–.A38 for further guidance about financial support from the owner-manager.

Period Beyond Management's Evaluation (Ref: par. .15)

.A25 The inquiry required by paragraph .15 is not intended to require management to extend its evaluation beyond the requirements of the applicable financial reporting framework. Other than inquiry of management, the auditor does not have a responsibility to perform any other audit procedures to identify conditions or events that may raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time beyond the period evaluated by management.

.A26 The applicable financial reporting framework may provide guidance about whether or how conditions or events that occur after the period required by the applicable financial reporting framework may affect the evaluation of whether substantial doubt about an entity's ability to continue as a going concern exists. For example, the GASB statements require that, if a governmental entity currently knows of information that may raise substantial doubt shortly after one year beyond the financial statement date, such information should be considered in the evaluation of substantial doubt.[27]

[26] "Pending Content" in FASB ASC 205-40 and paragraphs 16–19 of GASB Statement No. 56.

.A27 FASB ASC requires the evaluation to include events and conditions that may raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).[28] Therefore, the conditions or events known after this time period will not affect the evaluation of whether substantial doubt exists but may affect other disclosure requirements or consideration of whether the financial statements are fairly presented.

Additional Audit Procedures When Events or Conditions Are Identified (Ref: par. .16)

.A28 Audit procedures that may be relevant to performing the requirements in paragraph .16 include the following:

a. Analyzing and discussing cash flow, profit, and other relevant forecasts with management

b. Analyzing and discussing the entity's latest available interim financial statements

c. Reading the terms of debentures and loan agreements and determining whether any have been breached

d. Reading minutes of the meetings of shareholders, those charged with governance, and relevant committees, for reference to financial difficulties

e. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's evaluations of their outcome and the estimate of their financial implications

f. Evaluating the entity's plans to deal with unfilled customer orders

g. Performing audit procedures regarding subsequent events to identify those that either mitigate or exacerbate substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time

h. Confirming the existence, terms, and adequacy of borrowing facilities

i. Obtaining and reviewing reports of regulatory actions

j. Determining the adequacy of support for any planned disposals of assets

Evaluating Management's Plans (Ref: par. .16b–c)

.A29 Evaluating management's plans may include performing audit procedures that the auditor considers necessary in the circumstances regarding management's plans for future action, including, for example, its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital. For governmental entities, evaluating management's plans may also include management's plans for future

[27]Paragraph 16 of GASB Statement No. 56.

[28]"Pending Content" in FASB ASC 205-40-50-1.

actions, including, for example, its plans to increase taxes to the extent allowable by law (as well as obtaining the necessary approvals to do so) or to issue additional debt up to the legal debt limit. See paragraphs .A8–.A10 for examples of other plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

.A30 In addition to the procedures required in paragraph .16*c*, the auditor may compare

a. the prospective financial information used in recent prior periods with historical results and

b. the prospective financial information used in the current period with results achieved to date.

.A31 When evaluating a cash flow forecast, an example of contradictory evidence may include assumptions in the cash flow forecasts that are inconsistent with assumptions used for other purposes, such as forecasts used to evaluate the recoverability of deferred tax assets or potential impairment of goodwill or long-lived assets.

Financial Support by Third Parties or the Entity's Owner-Manager

Intent

Support Letters or Written Confirmations

.A32 The auditor's evaluation of the support letter (as further described in paragraph .A33) or written confirmation includes consideration of the terms and conditions of the commitment and may include, as applicable, considerations of the legality and enforceability of the commitments.

.A33 The intent of supporting parties to provide the necessary financial support may be evidenced by either of the following:

a. Obtaining from management written evidence of a commitment from the supporting party to provide or maintain the necessary financial support (sometimes referred to as a "support letter").

b. Confirming directly with the supporting parties (as described in paragraph .A35) the existence of commitments to provide or maintain the necessary financial support. Confirmation may be necessary if management only has oral evidence of such financial support.

.A34 When the financial support is provided by an owner-manager, the evidence regarding intent may be in the form of a support letter or a written representation.[29]

Obtaining Written Confirmations

[29]See section 580, *Written Representations*.

.A35 If the auditor obtains a support letter as described in paragraph .A33*a*, the auditor may still request a written confirmation in accordance with section 505, *External Confirmations*, from the supporting parties regarding the contents of the support letter. For example, such written confirmation may be requested when, in the auditor's professional judgment, a written confirmation is necessary to determine the validity of the support letter as well as the accuracy and completeness of the related terms and conditions.

Illustration of the Third-Party Support Letter

.A36 The purpose of the support letter from supporting parties is to provide sufficient appropriate audit evidence about the supporting parties' intent to provide financial support to the entity. The support letter may also include additional material facts and circumstances that may be pertinent to the determination of whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. The following is an illustration of a support letter that may be requested from the supporting parties when the applicable financial reporting framework is FASB ASC. The illustrative wording also includes an assertion about the supporting party's ability to provide financial support, but such wording does not, by itself, provide sufficient appropriate audit evidence regarding ability.

> *(Supporting party name)* will, and has the ability to, fully support the operating, investing, and financing activities of *(entity name)* through at least one year and a day beyond [insert date][30] (*the date the financial statements are issued or available for issuance, when applicable)*.

Depending on the facts and circumstances, this written support letter may be adapted, for example, by adding the following wording:

> This also applies to any amounts that may ultimately be due to the Internal Revenue Service as a result of the recent judgment against *(entity name)* and also applies should *(entity name's)* debt not be refinanced when the debt becomes due in the next year.

.A37 In accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report 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.[31] Accordingly, in order to cover the assessment period required by the applicable financial reporting framework, the support letter or the written confirmation defines a specific date

[30] See paragraph .A37.

[31] Paragraph .43 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .82 and .126 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

through which the supporting party intends to provide support. For example, for financial statements prepared in accordance with FASB ASC, the date would be a year and a day beyond the date that the financial statements are issued (or available to be issued, when applicable). Specifying a date in the support letter or written confirmation that is later than the expected date that the financial statements will be issued (or will be available to be issued, when applicable) may obviate the need to obtain updated information from the supporting parties. The period covered by the support letter or written confirmation may be shorter if there is another source of support that management intends to utilize in order to continue as a going concern through the assessment period. Such other support would be subjected to the same auditing procedures discussed in this section. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Ability

.A38 With respect to the supporting party's ability to provide support, matters to which the auditor may give consideration include the following:

a. Audit evidence of past support obtained from the supporting party when such support was needed.

b. The solvency of the supporting party and the sufficiency of the evidence supporting the solvency assertion. The auditor may obtain financial statements of the supporting party audited by a reputable auditor as evidence of the ability of the supporting party to provide the needed support. If the financial statements have not been audited, the auditor may perform other procedures, such as obtaining bank statements and evidence regarding the valuation of assets held by the supporting party that may be used to provide the needed support. However, these procedures might not provide evidence regarding other claims on the pledged assets that would limit the ability of the supporting party to use the assets to provide the support to the reporting entity.

c. The ability to provide the needed support in a timely manner for the reporting entity to meet its obligations.

d. When the entity and supporting party are in different countries, the ability of the supporting party to transfer the necessary funds (or other financial support) to the entity. Factors such as trade embargos, financial transfer restrictions, and war may limit the ability to transfer the necessary financial support.

Given the nature of these matters, the auditor may consult with legal counsel, as appropriate.

Written Representations (Ref: par. .18)

.A39 The auditor may consider it appropriate to request specific written representations beyond those required in paragraph .18 in support of audit evidence obtained regarding management's plans in relation to its going concern evaluation and the feasibility of those plans to alleviate substantial doubt.

.A40 Paragraph .26 of section 580, *Written Representations*, addresses situations in which management does not provide one or more of the requested written representations.

Auditor Conclusions

Substantial Doubt About the Entity's Ability to Continue as a Going Concern (Ref: par. .20–.21)

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.A41 Some financial reporting frameworks provide requirements about management's responsibilities to evaluate whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time and provide explicit requirements about financial statement disclosures.

.A42 For example, under FASB ASC, if, after considering management's plans, substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is not alleviated — that is, substantial doubt exists — the entity is required to include a statement in the notes to the financial statements indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date the financial statements are available to be issued, when applicable). Additionally, the entity is required to disclose information that enables users of the financial statements to understand[32]

a. principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

b. management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.

c. management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

.A43 For example, under the GASB statements, if it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, the notes to the financial statements are required to include disclosure of the following, as appropriate:[33]

a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the governmental entity's ability to continue as a going concern for a reasonable period of time

b. The possible effects of such conditions and events

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[32]"Pending Content" in FASB ASC 205-40-50-13.

[33]Paragraph 19 of GASB Statement No. 56.

c. Government officials' evaluation of the significance of those conditions and events and any mitigating factors

d. Possible discontinuance of operations

e. Government officials' plans (including relevant prospective financial information)

f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

.A44 Under the GASB statements, management's discussion and analysis (MD&A) is required to include a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the governmental entity's financial position or results of operations. If it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, it may be necessary to include a discussion of going concern issues in the MD&A, depending on the facts and circumstances.[34] This discussion of going concern issues is presented as required supplementary information, and the auditor is required to perform procedures on the required supplementary information in accordance with section 730, *Required Supplementary Information*, as applicable.[35]

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans (Ref: par. .22)

.A45 Even in situations when events or conditions that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time have been identified, but management concludes that no substantial doubt exists after considering its plans, the auditor is required by paragraph .22 to evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. For example, FASB ASC states that, if substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is alleviated as a result of consideration of management's plans, an entity shall disclose in a note to the financial statements information that enables users of the financial statements to understand all of the following (or shall refer to similar information disclosed elsewhere in the footnotes):[36]

a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time (before consideration of management's plans)

b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations

c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time

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[34]Paragraph 11h of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and paragraph 19 of GASB Statement No. 56.

[35]Paragraph 129 of GASB Statement No. 34.

[36]"Pending Content" in FASB ASC 205-40-50-12.

.A46 The auditor's evaluation about whether the financial statements achieve fair presentation includes the consideration of 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.[37] Depending on the facts and circumstances, the auditor may determine that additional disclosures are necessary to achieve fair presentation.

.A47 In the absence of disclosures explicitly required by the applicable financial reporting framework that address management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time, the auditor may consider the disclosure guidance set out in paragraphs .A42–.A46 in considering whether the financial statements are fairly presented.

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting Is Inappropriate (Ref: par. .23)

.A48 The requirement in paragraph .23 for the auditor to express an adverse opinion applies regardless of whether the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting.

.A49 When the use of the going concern basis of accounting is not appropriate in the circumstances, management may be required, or may elect, to prepare the financial statements on another basis (for example, under FASB ASC, the entity is required to comply with FASB ASC 205-30 and prepare the financial statements using the liquidation basis of accounting when an entity's liquidation becomes imminent).

.A50 Interpretation No. 1, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting", of section 700, *Forming an Opinion and Reporting on Financial Statements* (sec. 9700 par. .01–.05), addresses the situation in which an auditor issues an unmodified opinion on the entity's financial statements prepared under the liquidation basis of accounting and the auditor determines an emphasis-of-matter paragraph is appropriate.

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified (Ref: par. .24–.25)

Conditions and Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.A51 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[37] Paragraph .17 of section 700.

.A52 The exhibit to this section provides an illustration of the statements that are required to be included in the auditor's report on the financial statements (illustration 1) and an illustration of the circumstances described in paragraph .A54 (illustration 2). Illustration 1 and illustration 2 provide examples in which FASB ASC is the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC is used, the wording in the illustrative reports in the exhibit to this section may need to be adapted to reflect the application of the other financial reporting framework in the circumstances. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A53 When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the auditor's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Conditions and Events Have Been Identified and Substantial Doubt Has Been Alleviated

.A54 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.[38] In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the auditor concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the auditor is required by paragraph .24 of this section to include a separate "Going Concern" section in the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A55 As indicated in section 706, the use of an emphasis-of-matter paragraph is not appropriate if either of the following applies:

a. The matter has been determined to be a key audit matter when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies.

[38]Paragraphs .08–.09 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report.*

b. The auditor would be required to modify the opinion in accordance with section 705[39] as a result of the matter.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A56 As indicated in section 705, in circumstances in which conditions and events have been identified and the auditor concludes that, based on the audit evidence obtained, the disclosures are materially misstated, the auditor is required to modify the auditor's report.[40] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Inappropriate Use of Conditional Language

.A57 Examples of conditional language that are inappropriate to use in the "Going Concern" section include the following:

a. If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.

b. The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Communication With Regulators

.A58 When the auditor of a regulated entity considers that it may be necessary to include a reference to going concern matters in the auditor's report, the auditor may have a duty to communicate with the applicable regulatory, enforcement, or supervisory authorities. (Ref: par. .24) [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Management Unwilling to Perform or Extend Its Evaluation (Ref: par. .27)

.A59 In certain circumstances, the auditor may believe it necessary to request that management perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework. If management is unwilling to do so, a qualified or adverse opinion in the auditor's report may be appropriate. For example, management may be unwilling to extend its evaluation because it believes it has satisfied the requirements to conclude whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time when the applicable financial reporting framework

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[39] Paragraph .08 of section 706. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[40] Paragraph .07 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

requires management to make this evaluation. If, in the auditor's judgment, management's conclusion is not adequately supported, the auditor may conclude that a qualified or adverse opinion for a departure from the applicable financial reporting framework is appropriate in these circumstances. Section 705 provides guidance related to the modification of the auditor's opinion. In addition, management's unwillingness to make or extend its evaluation to meet the period of time required by the applicable financial reporting framework may be an indicator of a deficiency in internal control that is required to be evaluated to determine whether it constitutes a significant deficiency or material weakness in accordance with section 265. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Comparative Presentations (Ref: par. .29)

.A60 Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, does not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. Section 700 and section 703 provide guidance on reporting when financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A61 A financial reporting framework may contain disclosure requirements in a subsequent period in which substantial doubt no longer exists. For example, FASB ASC states that for the period in which substantial doubt no longer exists (before or after consideration of management's plans), an entity shall disclose how the relevant conditions or events that raised substantial doubt were resolved.[41] [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Eliminating a Going Concern Emphasis-of-Matter Paragraph From a Reissued Report (Ref: par. .30)

.A62 After the auditor has issued the auditor's report containing a "Going Concern" section, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the "Going Concern" section that appeared in the original report. Such requests may occur after the conditions or events that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A63 The auditor may perform procedures in addition to those required by paragraph .30 that the auditor deems necessary in the circumstances. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

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[41] "Pending Content" in FASB ASC 205-40-50-14. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .32)

.A64 Section 230, *Audit Documentation*, addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements.[42] The documentation requirements of paragraph .32 of this section are incremental to section 230 and apply when the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

[42] Paragraph .01 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

Exhibit — Illustrations of Auditor's Reports Relating to Going Concern (Ref: par. .A52–.A56)

.A65

Illustration 1 — An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

Illustration 2 — An Auditor's Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated

Illustration 1 — An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.
- The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.
- The auditor has concluded, after considering identified conditions or events and management's plans, that substantial doubt remains and the disclosures of the conditions or events and management's plans are adequate.
- Management is required under FASB ASC to include an explicit statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.

Independent Auditor's Report

To the Shareholders of ABC Company [*or Other Appropriate Addressee*]

The auditor's report is presented in accordance with paragraphs .21–.42 of section 700, *Forming an Opinion and Reporting on Financial Statements*. For illustrative purposes, the Going Concern section is presented immediately after the "Basis for Opinion of the Auditor's Report" section.

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Illustration 2 — An Auditor's Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated (Ref: par. .A52)

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.
- Management has disclosed conditions or events, considered in the aggregate, that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- Management has disclosed its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity's ability to meet its obligations.
- Management has disclosed that the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans.
- The auditor has concluded that management's disclosures are adequate.

Independent Auditor's Report

To the Shareholders of ABC Company [*or Other Appropriate Addressee*]

Report on the Audit of the Financial Statements

The auditor's report is presented in accordance with paragraph .09 of section 706, *Emphasis-of Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

Emphasis-of-Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

AU-C Section 580

Written Representations

Source: SAS No. 122; SAS No. 135; SAS No. 136; SAS No. 143.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to obtain written representations from management and, when appropriate, those charged with governance in an audit of financial statements.

.02 Exhibit D, "List of AU-C Sections Containing Requirements for Written Representations," lists other AU-C sections containing subject matter-specific requirements for written representations. The specific requirements for written representations of other AU-C sections do not limit the application of this section.

Written Representations as Audit Evidence

.03 *Audit evidence* is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.[1] Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. (Ref: par. .A1)

.04 Although written representations provide necessary audit evidence, they complement other auditing procedures and do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, obtaining reliable written representations does not affect the nature or extent of other audit procedures that the auditor applies to obtain audit evidence about the fulfillment of management's responsibilities or about specific assertions.

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

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[1]Paragraph .06 of section 500, *Audit Evidence*. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

Objectives

.06 The objectives of the auditor are to

a. obtain written representations from management and, when appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation and fair presentation of the financial statements and for the completeness of the information provided to the auditor;

b. support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other AU-C sections; and

c. respond appropriately to written representations provided by management and, when appropriate, those charged with governance or if management or, when appropriate, those charged with governance do not provide the written representations requested by the auditor.

Definition

.07 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Written representation. A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

.08 For purposes of this section, references to *management* are to be read as "management and, when appropriate, those charged with governance" unless the context suggests otherwise.

Requirements

Management From Whom Written Representations Are Requested

.09 The auditor should request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: par. .A2–.A6)

Written Representations About Management's Responsibilities

Preparation and Fair Presentation of the Financial Statements

.10 The auditor should request management to provide a written representation that it has fulfilled its responsibility, as set out in the terms of the audit engagement,

a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and

b. for 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.[2] (Ref: par. .A7–.A10, .A22, and .A29)

Information Provided and Completeness of Transactions

.11 The auditor should request management to provide written representations that

a. it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement, and

b. all transactions have been recorded and are reflected in the financial statements. (Ref: par. .A7–.A10, .A22, and .A29)

Other Written Representations

Fraud

.12 The auditor should request management to provide written representations that it

a. acknowledges its responsibility for the design, implementation, and maintenance of internal controls to prevent and detect fraud;

b. has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud;

c. has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving

   i. management,

   ii. employees who have significant roles in internal control, or

   iii. others when the fraud could have a material effect on the financial statements; and

d. has disclosed to the auditor its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others. (Ref: par. .A11)

Laws and Regulations

.13 The auditor should request management to provide written representations that all instances of identified or suspected noncompliance with laws and regulations whose effects should be considered by management when preparing financial statements have been disclosed to the auditor.[3]

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[2]Paragraph .06*b*(i–ii) of section 210A, *Terms of Engagement*.

Uncorrected Misstatements

.14 The auditor should request management to provide written representations about whether it believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation. (Ref: par. .A12)

Litigation and Claims

.15 The auditor should request management to provide written representations that all known actual or possible litigation and claims whose effects should be considered by management when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Estimates

.16 The auditor should request written representations from management and, when appropriate, those charged with governance about whether the methods, significant assumptions, and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement, or disclosure that is in accordance with the applicable financial reporting framework. The auditor should also consider the need to obtain representations about specific accounting estimates, including in relation to the methods, assumptions, or data used. (Ref: par. .A13–.A14)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Related Party Transactions

.17 The auditor should request management to provide written representations that (Ref: par. .A15–.A16)

a. it has disclosed to the auditor the identity of all the entity's related parties and all the related party relationships and transactions of which it is aware and

b. it has appropriately accounted for and disclosed such relationships and transactions.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Subsequent Events

.18 The auditor should request management to provide written representations that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. (Ref: par. .A17)

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[3]Paragraph .A18 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

Additional Written Representations About the Financial Statements

.19 Other AU-C sections require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor should request such other written representations. (Ref: par. .A18–.A22 and .A29)

Date of, and Period(s) Covered by, Written Representations

.20 The date of the written representations should be as of the date of the auditor's report on the financial statements. The written representations should be for all financial statements and period(s) referred to in the auditor's report. (Ref: par. .A23–.A26)

Form of Written Representations

.21 The written representations should be in the form of a representation letter addressed to the auditor. (Ref: par. .A27–.A28)

Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt About the Reliability of Written Representations

.22 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 or written) and audit evidence in general. (Ref: par. .A30)

.23 In particular, if written representations are inconsistent with other audit evidence, the auditor should perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor should reconsider the assessment of the competence, integrity, ethical values, or diligence of management or of management's commitment to, or enforcement of, these and should determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: par. .A31)

.24 If the auditor concludes that the written representations are not reliable, the auditor should take appropriate action, including determining the possible effect on the opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, considering the requirement in paragraph .25 of this section.

Written Representations About Management's Responsibilities

.25 The auditor should disclaim an opinion on the financial statements in accordance with section 705 or withdraw from the engagement if (Ref: par. .A32–.A33)

a. the auditor concludes that sufficient doubt exists about the integrity of management such that the written representations required by paragraphs .10–.11 are not reliable or

b. management does not provide the written representations required by paragraphs .10–.11.

Requested Written Representations Not Provided

.26 If management does not provide one or more of the requested written representations, the auditor should

a. discuss the matter with management;

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

c. take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with section 705, considering the requirement in paragraph .25 of this section. (Ref: par. .A34)

Application and Other Explanatory Material

Written Representations as Audit Evidence (Ref: par. .03)

.A1 Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written rather than oral representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Management From Whom Written Representations Are Requested (Ref: par. .09)

.A2 Written representations are requested from those with overall responsibility for financial and operating matters whom the auditor believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements.

.A3 Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements and the assertions therein on which to base the written representations.

.A4 In some cases, however, management may decide to make inquiries of others who participate in preparing the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include the following:

- An actuary responsible for actuarially determined accounting measurements
- Staff engineers who may have responsibility for environmental liability measurements
- Internal counsel who may provide information essential to provisions for legal claims

.A5 To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations. It is not expected that such inquiries would usually require a formal internal process beyond those already established by the entity.

.A6 In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if, in the auditor's professional judgment, the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

Written Representations About Management's Responsibilities (Ref: par. .10–.11)

.A7 Audit evidence obtained during the audit that management has fulfilled the responsibilities referred to in paragraphs .10–.11 is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and fairly presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgment and understanding of its responsibilities. For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed upon in the terms of the audit engagement without asking management whether, and receiving confirmation that, such information has been provided.

.A8 The written representations required by paragraphs .10–.11 draw on the agreed acknowledgment and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. In addition to requesting management to confirm that it has fulfilled its responsibilities, the auditor also may ask management to reconfirm its acknowledgment and understanding of those responsibilities in written representations. This is common but, in any event, may be particularly appropriate when

- those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities,
- the terms of the audit engagement were prepared in a previous year,
- any indication exists that management misunderstands those responsibilities, or
- changes in circumstances make it appropriate to do so.

Consistent with the requirement of section 210A, *Terms of Engagement*, such reconfirmation of management's acknowledgment and understanding of its responsibilities is unconditional and is not made subject to the best of management's knowledge and belief (as discussed in paragraph .A6 of this section).

.A9 Relevant information may include such matters as the following:

- Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared
- Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices

Considerations Specific to Governmental Entities

.A10 The legal or regulatory requirements for audits of the financial statements of governmental entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a governmental entity is conducted may give rise to additional written representations. These may include written representations confirming that transactions and events have been carried out in accordance with applicable law or regulation.

Other Written Representations

Fraud (Ref: par. .12)

.A11 The written representations relating to fraud required by paragraph .12 are important for the auditor to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud.

Uncorrected Misstatements (Ref: par. .14)

.A12 Because the preparation of the financial statements requires management to adjust the financial statements to correct material misstatements, the auditor is required to request management to provide a written representation about uncorrected misstatements. In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as "We do not agree that items ... and ...

constitute misstatements because [*description of reasons*]." Obtaining this representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*.

Estimates (Ref: par. .16)

.A13 Written representations about specific accounting estimates may include representations

- that the significant judgments made in making the accounting estimates have taken into account all relevant information of which management is aware.
- about the consistency and appropriateness in the selection or application of the methods, assumptions, and data used by management in making the accounting estimates.
- that the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity when relevant to the accounting estimates and disclosures.
- that disclosures related to accounting estimates, including disclosures describing estimation uncertainty, are complete and reasonable in the context of the applicable financial reporting framework.
- that appropriate specialized skills or expertise has been applied in making the accounting estimates.
- that no subsequent event requires adjustment to the accounting estimates and related disclosures included in the financial statements.
- when accounting estimates are not recognized or disclosed in the financial statements, about the appropriateness of management's decision that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A14 [Paragraph deleted by the issuance of SAS No. 143, July 2020.][4]

Related Parties (Ref: par. .17)

.A15 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that (*a*) materially affect the financial statements or (*b*) involve management

[4][Footnote deleted by the issuance of SAS No. 143, July 2020.]

- When they have made specific oral representations to the auditor on details of certain related party transactions
- When they have financial or other interests in the related parties or the related party transactions

.A16 The auditor also may decide to obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements, or that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Subsequent Events (Ref: par. .18)

.A17 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses circumstances when the auditor includes an additional date on the auditor's report (that is, dual-dates the auditor's report for a revision relating to a subsequent event).[5] In such circumstances, the auditor may determine that obtaining additional representations relating to the subsequent event is appropriate.

Additional Written Representations About the Financial Statements (Ref: par. .19)

.A18 In addition to the written representations required by paragraphs .10–.18, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representations required by paragraphs .10–.18. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate
- Whether matters such as the following, when relevant under the applicable financial reporting framework, have been recognized, measured, presented, or disclosed in accordance with that framework:
  - — Plans or intentions that may affect the carrying value or classification of assets and liabilities
  - — Liabilities, both actual and contingent
  - — Title to, or control over, assets and the liens or encumbrances on assets and assets pledged as collateral
- Aspects of laws, regulations, and contractual agreements that may affect the financial statements, including noncompliance
- Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor

[5]Paragraph .13 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

Exhibit B, "Illustrative Specific Written Representations," contains illustrations of additional representations that may be appropriate in certain situations. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Additional Written Representations About Information Provided to the Auditor

.A19 In addition to the written representation required by paragraph .11, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

Written Representations About Specific Assertions

.A20 When obtaining evidence about or evaluating judgments and intentions, the auditor may consider one or more of the following:

- The entity's past history in carrying out its stated intentions
- The entity's reasons for choosing a particular course of action
- The entity's ability to pursue a specific course of action
- The existence, or lack thereof, of any other information obtained during the course of the audit that may be inconsistent with management's judgment or intent

.A21 In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent regarding, or the completeness of, a specific assertion. For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Communicating a Threshold Amount (Ref: par. .10–.11 and .19)

.A22 Management's representations may be limited to matters that are considered either individually or collectively material to the financial statements, provided management and the auditor have reached an understanding on materiality for this purpose. Materiality may be different for different representations. A discussion of materiality may be included explicitly in the representation letter in either qualitative or quantitative terms. Materiality considerations do not apply to those representations that are not directly related to amounts included in the financial statements (for example, management's representations about the premise underlying the audit). In addition, because of the possible effects of fraud on other aspects of the audit, materiality would not apply to management's acknowledgment regarding its responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

Date of, and Period(s) Covered by, Written Representations (Ref: par. .20)

.A23 Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to, or disclosure in, the financial statements, the written representations are dated as of the date of the auditor's report on the financial statements.

.A24 In some circumstances, it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. When this is the case, it may be necessary to request an updated written representation.

.A25 The written representations cover all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

.A26 Situations may arise in which current management was not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Form of Written Representations (Ref: par. .21)

.A27 Occasionally, circumstances may prevent management from signing the representation letter and returning it to the auditor on the date of the auditor's report. In those circumstances, the auditor may accept management's oral confirmation, on or before the date of the auditor's report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the auditor's report thereby providing sufficient appropriate audit evidence for the auditor to date the report. However, possession of the signed management representation letter prior to releasing the auditor's report is necessary because paragraph .21 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the auditor that, had it been known to the auditor at the date of the auditor's report, might affect the auditor's report and result in the need for updated representations. Section 560 addresses the auditor's responsibilities in such circumstances.

.A28 Exhibit A, "Illustrative Representation Letter," provides an illustrative example of a representation letter.

Communication With Those Charged With Governance (Ref: par. .10–.11 and .19)

.A29 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance the written representations that the auditor has requested from management.[6]

Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt About the Reliability of Written Representations (Ref: par. .22–.23)

.A30 Concerns about the competence, integrity, ethical values, or diligence of management or about its commitment to, or enforcement of, these may cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. In such a case, the auditor may consider withdrawing from the engagement, when withdrawal is possible under applicable law or regulation, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the auditor to issue an unmodified audit opinion.

.A31 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.

Written Representations About Management's Responsibilities (Ref: par. .25)

.A32 As explained in paragraph .A7, the auditor is not able to judge solely on other audit evidence whether management has fulfilled the responsibilities referred to in paragraphs .10–.11. Therefore, if, as described in paragraph .25*a*, the auditor concludes that the written representations about these matters are unreliable or if management does not provide those written representations, the auditor is unable to obtain sufficient appropriate audit evidence. The possible effects on the financial statements of such inability are not confined to specific elements, accounts, or items of the financial statements and are hence pervasive. Section 705 requires the auditor to disclaim an opinion on the financial statements in such circumstances.[7]

.A33 A written representation that has been modified from that requested by the auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the auditor's report. For example

- the written representation about management's fulfillment of its responsibility for the preparation and fair presentation of the financial statements may state that management believes that, except for material noncompliance with a particular requirement of the applicable financial reporting framework, the financial statements

[6]Paragraph .14*d* of section 260, *The Auditor's Communication With Those Charged With Governance*.

[7]Paragraph .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

are prepared and fairly presented in accordance with that framework. The requirement in paragraph .25 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effect of the noncompliance on the opinion in the auditor's report in accordance with section 705.

- the written representation about the responsibility of management to provide the auditor with all relevant information agreed upon in the terms of the audit engagement may state that management believes that, except for information destroyed in a fire, it has provided the auditor with such information. The requirement in paragraph .25 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effects of the pervasiveness of the information destroyed in the fire on the financial statements and the effect thereof on the opinion in the auditor's report in accordance with section 705.

Requested Written Representations Not Provided (Ref: par. .26)

.A34 Management's refusal to furnish written representations constitutes a limitation on the scope of the audit. Such refusal is often sufficient to preclude an unmodified opinion and, in particular with respect to the representations in paragraphs .12–.18, may cause an auditor to disclaim an opinion or withdraw from the engagement when withdrawal is possible under applicable law or regulation. However, based on the nature of the representations not obtained or the circumstances of the refusal, the auditor may conclude that a qualified opinion is appropriate.

Exhibit A — Illustrative Representation Letter

.A35 The following illustrative letter includes written representations that are required by this and other AU-C sections in effect for audits of financial statements for periods ending on or after December 15, 2012. It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States, that the requirement in section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to obtain a written representation is not relevant, and that no exceptions exist to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, for the purpose of expressing an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered to be material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of the surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

Except where otherwise stated below, immaterial matters less than $[*insert amount*] collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

We confirm that [*, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*] [*as of (date of auditor's report),*]:

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [*insert date*], for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. (par. .10*a*)
- We acknowledge our responsibility for 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. (par. .10*b*)
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud. (par. .12*a*)
- The methods, data, and significant assumptions used by us in making accounting estimates and their related disclosures are appropriate to achieve recognition, measurement, or disclosure that is reasonable in the context of the applicable financial reporting framework. (par. .16)

- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. (par. .17*b*)
- All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed. (par. .18)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (par. .14)
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with U.S. GAAP. (par. .15)

[*Any other matters that the auditor may consider appropriate (see paragraph .A21).*]

Information Provided

- We have provided you with:
  - — Access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters; (par. .11*a*)
  - — Additional information that you have requested from us for the purpose of the audit; (par. .11*a*) and
  - — Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence. (par. .11*a*)
- All transactions have been recorded in the accounting records and are reflected in the financial statements. (par. .11*b*)
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (par. .12*b*)
- We have [*no knowledge of any*] [*disclosed to you all information that we are aware of regarding*] fraud or suspected fraud that affects the entity and involves:
  - — Management;
  - — Employees who have significant roles in internal control; or
  - — Others when the fraud could have a material effect on the financial statements (par. .12*c*)
- We have [*no knowledge of any*] [*disclosed to you all information that we are aware of regarding*] allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (par. .12*d*)
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (par. .13)

- We [*have disclosed to you all known actual or possible*] [*are not aware of any pending or threatened*] litigation, claims, and assessments whose effects should be considered when preparing the financial statements [*and we have not consulted legal counsel concerning litigation, claims, or assessments*]. (par. .15)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (par. .17*a*)

[*Any other matters that the auditor may consider necessary (see paragraph .A21).*]

[*Name of Chief Executive Officer and Title*]

[*Name of Chief Financial Officer and Title*]

[Revised, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Exhibit B — Illustrative Specific Written Representations

.A36 As discussed in paragraph .19, the auditor may determine that a specific written representation is necessary to corroborate other audit evidence. Certain AICPA Audit and Accounting Guides recommend that the auditor obtain written representations concerning matters that are unique to a particular industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The existence of a condition listed subsequently does not mean that the representation is required; professional judgment is necessary to determine whether corroborative audit evidence in the form of a specific written representation is necessary.

Condition	Illustrative Specific Written Representation
General	
Unaudited interim information accompanies the financial statements.	The unaudited interim financial information accompanying [*presented in Note X to*] the financial statements for the [*identify all related periods*] has been prepared and fairly presented in conformity with generally accepted accounting principles applicable to interim financial information. The accounting principles used to prepare the unaudited interim financial information are consistent with those used to prepare the audited financial statements.
The effect of a new accounting principle is not known.	We have not completed the process of evaluating the effect that will result from adopting the guidance in Financial Accounting Standards Board (FASB) Accounting Standards Update 20YY-XX, as discussed in Note [*X*]. The company is therefore unable to disclose the effect that adopting the guidance in FASB Accounting Standards Update 20YY-XX will have on its financial position and the results of operations when such guidance is adopted.
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note [*X*] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of the assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with generally accepted accounting principles. We have considered both implicit and explicit variable interests in (*a*) determining whether potential VIEs should be considered VIEs, (*b*) calculating expected losses and residual returns, and (*c*) determining which party, if any, is the primary beneficiary. We have provided you with lists of all identified variable interests in (i) VIEs, (ii) potential VIEs that we considered but judged not to be VIEs, and (iii) entities that were afforded the scope exceptions of Financial Accounting Standards Board (FASB) *Accounting Standards Codification*™ (ASC) 810, *Consolidation*. We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810. We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents and other entities, in-

Condition	Illustrative Specific Written Representation
	cluding but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements. The information we provided about financial interests and contractual arrangements with related parties, de facto agents and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements. Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes. Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity. We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following: whether the entity is a VIE, whether the company is the primary beneficiary, or the accounting required to consolidate the entity.
The work of a specialist has been used by the entity.	We agree with the findings of specialists in evaluating the [*describe assertion*] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.
Assets	
Cash Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.
Financial Instruments Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.	Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities, to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.

Condition	Illustrative Specific Written Representation
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: [*describe methods and significant assumptions used to determine fair values of financial instruments*]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
Financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk exist.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: 1. The extent, nature, and terms of financial instruments with off-balance-sheet risk 2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments 3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments
Investments Unusual considerations are involved in determining the application of equity accounting.	[*For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:*] • The equity method is used to account for the company's investment in the common stock of [*investee*] because the company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the company's investment in the common stock of [*investee*] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.
The entity had loans to executive officers, nonaccrued loans or zero interest rate loans.	Loans to executive officers have been properly accounted for and disclosed.
Liabilities	
Debt Short-term debt could be refinanced on a long-term basis and management intends to do so.	The company has excluded short-term obligations totaling $[*amount*] from current liabilities because it intends to refinance the obligations on a long-term basis. [*Complete with appropriate wording detailing how amounts will be refinanced as follows:*] • The company has issued a long-term obligation [*debt security*] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis.

Condition	Illustrative Specific Written Representation
	• The company has the ability to consummate the refinancing, by using the financing agreement referred to in Note [*X*] to the financial statements.
Tax-exempt bonds have been issued.	Tax-exempt bonds issued have retained their tax-exempt status.
Taxes Management intends to reinvest undistributed earnings of a foreign subsidiary.	We intend to reinvest the undistributed earnings of [*name of foreign subsidiary*].
Pension and Postretirement Benefits An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
Involvement with a multiemployer plan exists.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of $[*XX*].
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of $[*XX*].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to the pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to the pension or other postretirement benefit plans.
Equity	
Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements exist.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

Exhibit C — Illustrative Updating Management Representation Letter

.A37 The following letter is presented for illustrative purposes only. It may be used in the circumstances described in paragraph .A17 of this section. Management need not repeat all of the representations made in the previous representation letter.

If matters to be disclosed to the auditor exist, they may be listed following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . . ."

[*Date*]

To [*Auditor*]

In connection with your audit(s) of the [*identification of financial statements*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of expressing an opinion as to whether the [*consolidated*] financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of [*name of entity*] in accordance with accounting principles generally accepted in the United States of America, you were previously provided with a representation letter under date of [*date of previous representation letter*]. No information has come to our attention that would cause us to believe that any of those previous representations should be modified.

To the best of our knowledge and belief, no events have occurred subsequent to [*date of latest balance sheet reported on by the auditor*] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

[*Name of Chief Executive Officer and Title*]

[*Name of Chief Financial Officer and Title*]

[Paragraph added, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Exhibit D — List of AU-C Sections Containing Requirements for Written Representations

.A38 This exhibit identifies paragraphs in other AU-C sections that require specific written representations that may not be required for every audit. The list is not a substitute for considering the requirements and related application and other explanatory material in AU-C sections:

- Paragraph .19 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraph .18 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Paragraph .55 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .36, .91, and .131 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable
- Paragraph .07*g* of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Paragraph .23 of section 935, *Compliance Audits*

In addition, certain AICPA Audit and Accounting Guides suggest written representations concerning matters that are unique to a particular industry.

[Paragraph renumbered, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

AU-C Section 585

Consideration of Omitted Procedures After the Report Release Date

Source: SAS No. 122.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when, subsequent to the report release date, the auditor becomes aware that one or more auditing procedures that the auditor considered necessary in the circumstances existing at the time of the audit were omitted from the audit of the financial statements. Section 560, *Subsequent Events and Subsequently Discovered Facts*, is applicable when a fact becomes known to the auditor after the report release date that, had it been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

.02 The provisions of this section do not apply to an engagement in which an auditor's work is at issue in a threatened or pending legal proceeding or regulatory investigation. A *threatened legal proceeding* means that a potential claimant has manifested to the auditor an awareness of, and a present intention to assert, a possible claim.

Effective Date

.03 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.04 The objectives of the auditor are to

a. assess the effect of omitted procedures of which the auditor becomes aware on the auditor's present ability to support the previously expressed opinion on the financial statements, and

b. respond appropriately.

Definition

.05 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Omitted procedure. An auditing procedure that the auditor considered necessary in the circumstances existing at the time of the audit of the financial statements but which was not performed.

Requirements

.06 If, subsequent to the report release date, the auditor becomes aware of an omitted procedure, the auditor should assess the effect of the omitted procedure on the auditor's present ability to support the previously expressed opinion on the financial statements. (Ref: par. .A1–.A4)

.07 If the auditor concludes that an omitted procedure of which the auditor has become aware impairs the auditor's present ability to support a previously expressed opinion on the financial statements and the auditor believes that there are users currently relying, or likely to rely, on the previously released report, the auditor should promptly perform the omitted procedure, or alternative procedures, to determine whether there is a satisfactory basis for the auditor's previously expressed opinion. The auditor should include in the audit documentation the procedures performed, in accordance with the provisions of section 230, *Audit Documentation*.[1] (Ref: par. .A3–.A5)

.08 When, as a result of the subsequent performance of an omitted procedure or alternative procedures, the auditor becomes aware of facts regarding the financial statements that existed at the report release date that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report, the auditor should apply the provisions of section 560.[2]

Application and Other Explanatory Material

.A1 The auditor's present ability to support the previously expressed opinion on the financial statements is dependent on whether the omitted procedure affects the auditor's conclusion that sufficient appropriate audit evidence was obtained. In accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the auditor is required to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.[3] (Ref: par. .06)

[1]Paragraph .14 of section 230, *Audit Documentation*.

[2]Paragraphs .15–.18 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[3]Paragraph .19 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

.A2 After the report release date, the auditor has no responsibility to carry out any retrospective review of the audit work performed. However, situations may arise in which the auditor becomes aware that an auditing procedure considered necessary by the auditor in the circumstances existing at the time of the audit was omitted. For example, after the report release date, reports and supporting audit documentation for particular engagements may be subjected to review in connection with a firm's inspection or monitoring process,[4] or otherwise, and the omission of a necessary audit procedure may be identified. (Ref: par. .06)

.A3 Procedures that the auditor may perform in connection with assessing the effect of an omitted procedure on the auditor's present ability to support a previously expressed opinion on financial statements include the following:

- Review of the audit documentation
- Discussion of the circumstances with engagement personnel and others within the firm
- Reevaluation of the overall scope of the audit

The results of other audit procedures that were performed may tend to compensate for the omitted procedure or make the effect of its omission less significant. Additionally, subsequent audits may provide audit evidence in support of the previously expressed opinion. (Ref: par. .06–.07)

.A4 The period of time during which the auditor considers whether this section applies to the circumstances of a particular engagement and then takes the actions, if any, that are required hereunder may be important. Because of the legal implications that may be involved in taking the actions contemplated herein, the auditor may decide to seek legal advice in determining an appropriate course of action. (Ref: par. .06–.07)

.A5 If, in the circumstances addressed in paragraph .07, the auditor is unable to perform a previously omitted procedure, or alternative procedures, to determine that there is a satisfactory basis for the auditor's previously expressed opinion, the auditor may decide to seek legal advice to determine an appropriate course of action concerning the auditor's responsibilities to the entity; regulatory authorities, if any, having jurisdiction over the entity; and users relying, or likely to rely, on the auditor's report. (Ref: par. .07)

[4] See QM section 10A, *A Firm's System of Quality Control*, regarding inspection in the context of the monitoring element of quality control.

AU-C Sections 600–699

USING THE WORK OF OTHERS

AU-C Section 600

Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)

(Supersedes SAS No. 122 section 600.)

Source: SAS No. 149.

Effective for audits of group financial statements for periods ending on or after December 15, 2026.

Introduction

Scope of This Section

.01 Generally accepted auditing standards (GAAS) apply to an audit of group financial statements (a group audit). This section applies to all group audits. It addresses special considerations that apply to a group audit, including in circumstances in which component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. The requirements and guidance in this section refer to, or expand on, the application of other relevant AU-C sections to a group audit, in particular, section 220, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*; section 230, *Audit Documentation*; section 300, *Planning an Audit*; section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. (Ref: par. .A1–.A2, .A32)

.02 Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph .16. The term *consolidation process* as used in this section refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework but also to the presentation of combined financial statements and to the aggregation of the financial information of entities or business units, such as branches or divisions. (Ref: par. .A3–.A5, .A30)

.03 Government entities frequently prepare group financial statements. AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.

.04 As explained in section 220,[1] this section, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this section may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

Groups and Components

.05 A group may be organized in various ways. For example, a group may be organized by legal or other entities, such as a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method. Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In this section, these different forms of organization are collectively referred to as *entities* or *business units*. (Ref: par. .A6)

.06 The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor's understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and controls. (Ref: par. .A7–.A9)

Involvement of Component Auditors

.07 Section 220[2] requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In a group audit, such resources may include component auditors, who are a part of the engagement team. Therefore, this section requires the group auditor to determine the nature, timing, and extent of involvement of component auditors.

.08 The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this section. Component auditors may have greater experience with and a more in-depth knowledge of the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit under the direction and supervision of the group auditor. (Ref: par. .A10–.A11)

.09 Audit risk is a function of the risks of material misstatement and detection risk.[3] Detection risk in a group audit includes the risk that a component auditor may not

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[1] Paragraph .A1 of section 220, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[2] Paragraph .25 of section 220.

detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this section requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this section explains the matters that the group auditor takes into account when determining the nature, timing, and extent of the direction and supervision of component auditors and the review of their work. (Ref: par. .A12–.A13)

Making Reference to the Audit of a Referred-to Auditor

.10 In accordance with this section, the group engagement partner may also determine to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements in situations when the referred-to auditor has performed an audit of component financial statements and issued an auditor's report thereon. Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. This section describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, a referred-to auditor is not a part of the engagement team. Therefore, when the terms *component auditor* and *engagement team* are used in this section, they do not include referred-to auditors. Accordingly, the requirements in paragraphs .51–.65 and the related application material specific to referred-to auditors are applicable, but the group auditor is not required to be involved in the work of referred-to auditors and therefore is not required to direct and supervise referred-to auditors or review their work. Paragraphs .51–.57 set out requirements for determining whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements when establishing the overall group audit strategy and group audit plan in accordance with paragraph .24 of this section. Therefore, when the group engagement partner plans to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the requirements in paragraphs .51–.65, in addition to other requirements related to the execution of the group audit, are relevant. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios" and par. .A165)

Professional Skepticism

.11 In accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,[4]the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate maintenance of professional skepticism may be demonstrated through the actions and communications of

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[3]Paragraph .A36 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards.*

[4]Paragraphs .17–.18 and .A22–.A28 of section 200.

the engagement team, including emphasizing the importance of each engagement team member maintaining professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate maintenance of professional skepticism. (Ref: par. .A14–.A18)

Scalability

.12 This section applies to all group audits, regardless of size or complexity. However, the requirements of this section are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this section are not relevant because they are conditional on the involvement of component auditors or on making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. This may be the case when the group auditor is able to perform audit procedures centrally or when the group auditor is able to perform procedures at the components without involving component auditors or making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. The guidance in paragraphs .A132–.A133 also may be helpful in applying this section in these circumstances. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios")

Responsibilities of the Group Engagement Partner and Group Auditor

.13 The group engagement partner remains ultimately responsible and therefore accountable for compliance with the requirements of this section. Nevertheless, the group engagement partner may seek assistance from others to fulfill these responsibilities. The phrase "the group engagement partner should take responsibility for..." or "the group auditor should take responsibility for..." is used for those requirements for which the group engagement partner or group auditor, respectively, is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this section expressly intends that the requirement or responsibility be fulfilled by the group engagement partner or group auditor, as applicable. In such circumstances, the group engagement partner or group auditor may need to obtain information from the firm or other members of the engagement team. For example, when others, including component auditors, perform supervisory and review activities, the outcomes of those activities can be taken into account by the group engagement partner or group auditor in fulfilling these responsibilities. (Ref: par. .A19 and .A33)

Effective Date

.14 This section is effective for audits of group financial statements for periods ending on or after December 15, 2026.

Objectives

.15 The objectives of the auditor are to do the following:

a. With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements

b. Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks

c. Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work

d. Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, as a basis for forming an opinion on the group financial statements

Definitions

.16 For purposes of GAAS, the following terms have the meanings attributed as follows:

aggregation risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: par. .A20)

component. An entity, business unit, function, or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: par. .A21–.A22)

component auditor. An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team[5] for a group audit. (Ref: par. .A23–.A26)

component management. Management responsible for a component. (Ref: par. .A27)

component performance materiality. An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

group. A reporting entity for which group financial statements are prepared.

group audit. The audit of group financial statements.

group auditor. The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for the following:

[5] Paragraph .12 of section 220.

i. Establishing the overall group audit strategy and group audit plan

ii. Directing and supervising component auditors and reviewing their work

iii. Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements

group audit opinion. The audit opinion on the group financial statements.

group engagement partner. The engagement partner[6] responsible for the group audit. (Ref: par. .A28)

group financial statements. Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this section, a consolidation process includes one or more of the following: (Ref: par. .A29–.A31)

i. Consolidation, proportionate consolidation, inclusion, or an equity method of accounting

ii. The presentation in combined financial statements of the financial information of entities or business units that are under common control or common management

iii. The aggregation of the financial information of entities or business units such as branches or divisions

group management. Management responsible for the preparation of the group financial statements.

group performance materiality. Performance materiality[7] in relation to the group financial statements as a whole, as determined by the group auditor.

referred-to auditor. An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.

.17 Reference in this section to *the applicable financial reporting framework* means the financial reporting framework that applies to the group financial statements. (Ref: par. .A32)

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[6] See footnote 5.

[7] Paragraphs .09 and .11 of section 320, *Materiality in Planning and Performing an Audit.*

Requirements

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

.18 In applying section 220,[8]the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner should do the following: (Ref: par. .A33–.A34)

a. Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members (Ref: par. .A35)

b. Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement

Acceptance and Continuance

.19 Before accepting or continuing the group audit engagement, the group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained (including through involving component auditors or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements) to provide a basis for forming an opinion on the group financial statements. (Ref: par. .A36–.A41, .A43)

.20 If after the acceptance or continuance of the group audit engagement the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner should consider the possible effects on the group audit. (Ref: par. .A42)

Terms of Engagement

.21 In applying section 210, *Terms of Engagement*,[9]the group auditor should obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with the following: (Ref: par. .A44)

a. Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation, and other matters

b. Additional information that the engagement team may request from group management or component management for the purpose of the group audit

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[8]Paragraph .13 of section 220.

[9]Paragraphs .06*b* and .08*b* of section 210, *Terms of Engagement*.

c. Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence

Restrictions on Access to Information or People Outside the Control of Group Management

.22 If the group engagement partner concludes that group management cannot provide the engagement team with access to information or unrestricted access to persons within the group due to restrictions that are outside the control of group management, the group engagement partner should consider the possible effects on the group audit. (Ref: par. .A45–.A53)

Restrictions on Access to Information or People Imposed by Group Management

.23 If the group engagement partner concludes that (Ref: par. .A50–.A53)

a. it will not be possible for the group auditor to obtain sufficient appropriate audit evidence due to restrictions imposed by group management, and

b. the possible effect of this limitation will result in a disclaimer of opinion on the group financial statements, the group engagement partner should either

   i. in the case of an initial engagement, not accept the engagement, or, in the case of a recurring engagement, withdraw from the engagement, when withdrawal is possible under applicable law or regulation, or

   ii. when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements.

Overall Group Audit Strategy and Group Audit Plan

.24 In applying section 300,[10]the group auditor should establish, and update as necessary, an overall group audit strategy and group audit plan. In doing so, the group auditor should determine the following: (Ref: par. .A54–.A58)

a. The components at which audit work will be performed (Ref: par. .A59–.A60)

b. The resources needed to perform the group audit engagement, including the nature, timing, and extent to which component auditors are to be involved (Ref: par. .A61–.A65)

c. The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor (see paragraphs .51–.65)

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[10]Paragraphs .07–.10 of section 300, *Planning an Audit*.

d. For components that are accounted for by the equity method, whether to use audited financial statements as audit evidence regarding the noncontrolled entity's financial results (see paragraph .66) (Ref: par. .A66).

Considerations When Component Auditors Are Involved

.25 In establishing the overall group audit strategy and group audit plan, the group engagement partner should evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: par. .A67)

.26 As part of the evaluation in paragraph .25, the group auditor should request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: par. .A68)

Relevant Ethical Requirements, Including Those Related to Independence

.27 In applying section 220,[11] the group engagement partner should take responsibility for the following: (Ref: par. .A69–.A70, .A97)

1. Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement
2. Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

Engagement Resources

.28 In applying section 220,[12]the group engagement partner should do the following: (Ref: par. .A71–.A78)

a. Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component

b. If information about the results of the monitoring and remediation process or external inspections related to the component auditor has been provided by the group auditor's firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor's determination in paragraph .28*a*

.29 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if

[11] Paragraph .17 of section 220.

[12] Paragraphs .25–.26 of section 220.

a. the component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement,[13] or (Ref: par. .A79–.A80)

b. the group engagement partner has serious concerns about the matters in paragraphs .25–.28. (Ref: par. .A81)

Engagement Performance

.30 In applying section 220,[14] the group engagement partner should take responsibility for the nature, timing, and extent of direction and supervision of component auditors and the review of their work, taking into account the following: (Ref: par. .A82–.A87)

a. Areas of higher assessed risks of material misstatement of the group financial statements or significant risks identified in accordance with section 315

b. Areas in the audit of the group financial statements that involve significant judgment

Communications With Component Auditors

.31 The group auditor should communicate with component auditors about their respective responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: par. .A88–.A97)

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control

.32 In applying section 315A,[15]the group auditor should take responsibility for obtaining an understanding of the following: (Ref: par. .A98–.A103)

a. The group and its environment, including (Ref: par. .A104–.A106)

   i. the group's organizational structure and its business model, including

      1. the locations in which the group has its operations or activities,

      2. the nature of the group's operations or activities and the extent to which they are similar across the group, and

      3. the extent to which the group's business model integrates the use of IT

   ii. regulatory factors affecting the entities and business units in the group; and

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[13]Paragraphs .15–.16 of section 200.

[14]Paragraph .29 of section 220.

[15]Paragraphs .19–.31 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

iii. the measures used internally and externally to assess the financial performance of the entities or business units

b. The applicable financial reporting framework and the consistency of accounting policies and practices across the group

c. The group's system of internal control, including

i. the nature and extent of commonality of controls; (Ref: par. .A107–.A110, .A113)

ii. whether, and if so, how, the group centralizes activities relevant to financial reporting; (Ref: par. .A111–.A113)

iii. the consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and

iv. how group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's system of internal control to management of entities or business units (Ref: par. .A114–.A116)

Considerations When Component Auditors Are Involved

.33 The group auditor should communicate the following to component auditors on a timely basis: (Ref: par. .A117)

a. Matters that the group auditor determines to be relevant to the component auditor's design or performance of risk assessment procedures for purposes of the group audit, including identified significant risks of the group financial statements

b. In applying section 550, *Related Parties*,[16]related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor (Ref: par. .A118–.A119)

c. In applying section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, events or conditions identified by group management or the group auditor that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time that are relevant to the work of the component auditor

.34 The group auditor should request component auditors to communicate the following on a timely basis:

a. Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks

[16]Paragraph .19 of section 550, *Related Parties*.

of material misstatement of the group financial statements, whether due to fraud or error

b. Related party relationships not previously identified by group management or the group auditor (Ref: par. .A119)

c. Any events or conditions identified by the component auditor that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time

Identifying and Assessing the Risks of Material Misstatement

.35 In applying section 315,[17] based on the understanding obtained in paragraph .32, the group auditor should take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process. (Ref: par. .A120–.A125)

Considerations When Component Auditors Are Involved

.36 In applying section 315,[18]the group auditor should evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: par. .A126–.A127)

Materiality

.37 In applying section 320, *Materiality in Planning and Performing an Audit*,[19] and section 450, *Evaluation of Misstatements Identified During the Audit*,[20]when classes of transactions, account balances, or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, for those components on which the group auditor or component auditor will perform audit procedures, the group auditor should determine the following:

a. *Component performance materiality*. To address aggregation risk, such amount should be lower than group performance materiality. (Ref: par. .A128–.A134)

b. *The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor*. Such threshold should not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: par. .A135)

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[17]Paragraphs .32–.38 of section 315.

[18]Paragraph .39 of section 315.

[19]Paragraph .11 of section 320.

[20]Paragraph .05 of section 450, *Evaluation of Misstatements Identified During the Audit*.

Considerations When Component Auditors Are Involved

.38 The group auditor should communicate to the component auditor the amounts determined in accordance with paragraph .37. (Ref: par. .A136–.A137)

Responding to the Assessed Risks of Material Misstatement

.39 In applying section 330,[21]the group auditor should take responsibility for the nature, timing, and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing, and extent of the work to be performed at those components. (Ref: par. .A138–.A154)

Consolidation Process

.40 The group auditor should take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include the following: (Ref: par. .A155)

a. Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations

b. Evaluating the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications (Ref: par. .A156)

c. Evaluating whether management's judgments made in the consolidation process give rise to indicators of possible management bias

d. Responding to assessed risks of material misstatement due to fraud arising from the consolidation process

.41 If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor should evaluate whether the financial information has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework.

.42 If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor should take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.[22]

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[21]Paragraphs .06–.07 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[22]See, for example, FASB *Accounting Standards Codification* (ASC) 810, *Consolidation*.

Considerations When Component Auditors Are Involved

.43 When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor should communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.

.44 For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with section 315, for which a component auditor is determining the further audit procedures to be performed, the group auditor should evaluate the appropriateness of the design and performance of those further audit procedures. (Ref: par. .A157–.A158)

.45 When component auditors perform further audit procedures on the consolidation process, including on sub-consolidations, the group auditor should determine the nature and extent of direction and supervision of component auditors and the review of their work. (Ref: par. .A158)

.46 The group auditor should determine whether the financial information identified in the component auditor's communication (see paragraph .47*a*) is the financial information that is incorporated in the group financial statements.

Evaluating the Component Auditor's Communications and the Adequacy of Their Work

.47 The group auditor should request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following: (Ref: par. .A159)

a. Identification of the financial information on which the component auditor has been requested to perform audit procedures

b. Whether the component auditor has performed the work requested by the group auditor

c. Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement

d. Information about instances of noncompliance with laws or regulations

e. Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph .38 (Ref: par. .A160)

f. Indicators of possible management bias

g. Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed

h. Fraud or suspected fraud involving component management, employees at entities or business units who have significant roles in the group's system of internal control at the component, or others at entities or business units where the fraud resulted in a material misstatement of the component financial information

i. Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component

j. Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in written representations that the component auditor requested from component management

k. The component auditor's overall findings or conclusions (Ref: par. .A161)

.48 The group auditor should

a. discuss significant matters arising from communications with the component auditor, including those in accordance with paragraph .47, with the component auditor, component management, or group management, as appropriate, and

b. evaluate whether communications with the component auditor are adequate for the group auditor's purposes. If such communications are not adequate for the group auditor's purposes, the group auditor should consider the implications for the group audit. (Ref: par. A162)

.49 The group auditor should determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor should consider (Ref: par. .A163–.A164)

a. the nature, timing, and extent of the work performed by the component auditor,

b. the competence and capabilities of the component auditor as determined in accordance with paragraph .28*a*, and

c. the direction and supervision of the component auditor and review of their work.

.50 If the group auditor concludes that the work of the component auditor is not adequate for the group auditor's purposes, the group auditor should determine what additional audit procedures are to be performed and whether they are to be performed by a component auditor or the group auditor.

Considerations Regarding Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements

Understanding the Referred-to Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-to Auditors

.51 The group engagement partner should take responsibility for the following: (Ref: par. .A166)

a. Referred-to auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement

b. Confirming whether the referred-to auditors understand and will comply with the ethical requirements that are relevant to the group audit engagement, including those related to independence

Competence and Capabilities of Referred-to Auditors

.52 The group engagement partner should determine that referred-to auditors have the appropriate competence and capabilities. (Ref: par. .A167–.A169)

.53 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements if (Ref: par. .A170–.A171)

a. the referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement, or

b. the group engagement partner has serious concerns about the matters in paragraphs .51–.52.

Consolidation Process Considerations for Referred-to Auditors

.54 The group auditor should obtain an understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.

Determining Whether to Make Reference to the Audit of a Referred-to Auditor (Ref: par. .A172–.A180)

.55 Having obtained an understanding of the referred-to auditor in paragraphs .51–.54, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

.56 Reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless

a. the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS or the standards promulgated by the PCAOB (Ref: par. .A176), and

b. the referred-to auditor has issued an auditor's report that is not restricted as to use.

.57 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless both of the following occur:

a. The measurement, recognition, presentation, and disclosure criteria that are applicable to material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to material items in the group's financial statements under the financial reporting framework used by the group.

b. The group auditor has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to be involved in the audit of the component financial statements. (Ref: par. .A177–.A180)

.58 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the group auditor should obtain sufficient appropriate audit evidence with regard to such components by

a. performing the procedures required by this section, as applicable (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios"), and

b. reading the component's financial statements and the referred-to auditor's report thereon to identify significant matters (see paragraph .64).

Making Reference to the Audit of a Referred-to Auditor (Ref: par. .A181–.A184)

.59 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the report on the group financial statements should clearly indicate the following:

a. The component was not audited by the group auditor but was audited by the referred-to auditor.

b. The magnitude of the portion of the financial statements audited by the referred-to auditor.

c. When the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements

   i. the financial reporting framework used by the component, and

   ii. that the group auditor is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group in accordance with paragraph .41. (Ref: par. .A177)

d. When

   a. the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and

   b. the group engagement partner has determined that the referred-to auditor performed additional audit procedures in order to meet the relevant requirements of GAAS

      1. the set of auditing standards used by the referred-to auditor and

      2. that additional audit procedures were performed by the referred-to auditor to meet the relevant requirements of GAAS.

.60 If the group engagement partner determines to name a referred-to auditor in the auditor's report on the group financial statements

a. the referred-to auditor's express permission should be obtained, and

b. the referred-to auditor's report should be presented together with that of the auditor's report on the group financial statements.

.61 If the opinion of a referred-to auditor is modified or that audit report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section, the group auditor should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the group auditor should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section in the auditor's report on the group financial statements. (Ref. par. .A184)

*Communications With the Referred-to Auditor (Ref: **par. .A185–.A187**)*

.62 The group auditor should communicate the following to a referred-to auditor on a timely basis:

a. In accordance with paragraph .51, the ethical requirements that are relevant to the group audit engagement, including those related to independence

b. Related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the referred-to auditor (Ref: par. .A187)

c. A request that the referred-to auditor communicate the following on a timely basis:

   i. Confirmation that the referred-to auditor will cooperate with the group auditor

   ii. Related party relationships not previously identified by group management or the group auditor

iii. If the group engagement partner decides to name a referred-to auditor in the auditor's report on the group financial statements, the referred-to auditor's express permission for the group engagement partner to name the referred-to auditor in the auditor's report on the group financial statements in accordance with paragraph .60*a*.

.63 The group auditor should request a referred-to auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following:

i. Identification of the financial information of the component on which the referred-to auditor is reporting

ii. Whether the referred-to auditor has complied with ethical requirements that are relevant to the group audit engagement, including independence

iii. The referred-to auditor's report

Evaluating a Referred-to Auditor's Communication

.64 The group auditor should evaluate a referred-to auditor's communication (see paragraph .62*c* and .63). The group auditor should discuss matters arising from that evaluation, or significant matters identified in accordance with paragraph .58*b*, with the referred-to auditor, component management, or group management, as appropriate.

.65 The group auditor should determine whether the financial information identified in the referred-to auditor's communication (see paragraph. .63*a*) is the financial information that is incorporated in the group financial statements.

Considerations Regarding Using Audited Financial Statements of a Noncontrolled Entity That Is Accounted for by the Equity Method as Audit Evidence

.66 The group may have a noncontrolling interest in an entity that is accounted for by the equity method and for which audited financial statements of the noncontrolled entity are available. If the group auditor intends to use the audited financial statements as audit evidence regarding the noncontrolled entity's financial results, the group auditor should (Ref: par. .A188–.A191)

a. obtain and read the audited financial statements of the noncontrolled entity, including the accompanying audit report, and determine whether the audited financial statements are satisfactory for this purpose,

b. if the difference between the financial statement period of the group and the noncontrolled entity has or could have a material effect on the group financial statements, determine whether group management has properly considered the lack of comparability and determine the effect, if any, on the group auditor's report in accordance with section 708, *Consistency of Financial Statements*, and

c. if the carrying amount of the noncontrolled entity on the group financial statements is materially different from the underlying equity in net assets of the noncontrolled entity on the noncontrolled entity financial statements, obtain sufficient appropriate audit evidence for the material differences and determine that such differences are appropriate in accordance with the applicable financial reporting framework.

Subsequent Events

.67 In applying section 560, *Subsequent Events and Subsequently Discovered Facts*,[23]the group auditor should take responsibility for performing procedures, including, as appropriate, requesting component auditors or referred-to auditors to perform procedures designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. .A192–.A194)

Considerations When Component Auditors Are Involved

.68 The group auditor should request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. .A194)

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

.69 In applying section 330,[24]the group auditor should evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed (including from the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements) on which to base the group audit opinion. (Ref: par. .A195–.A199)

.70 The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. .A200)

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. .A201–.A202)

.71 When component auditors are involved in the group audit, no reference should be made to the component auditor in the auditor's report on the group financial statements.

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[23]Paragraphs .09–.10 of section 560, *Subsequent Events and Subsequently Discovered Facts.*

[24]Paragraph .28 of section 330.

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management

.72 The group auditor should communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: par. .A203)

.73 If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph .47*h*) or referred-to auditor, or information indicates that a fraud may exist, the group auditor should communicate this on a timely basis to the appropriate level of group management to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. .A204)

.74 When a component auditor or a referred-to auditor has been engaged to express an audit opinion on the financial statements of an entity or business unit that forms part of the group, the group auditor should request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor or referred-to auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved and whether to withdraw from the engagement. (Ref: par. .A205–.A206)

Communication With Those Charged With Governance of the Group

.75 The group auditor should communicate the following matters with those charged with governance of the group, in addition to those required by section 260, *The Auditor's Communication With Those Charged With Governance* and other AU-C sections: (Ref: par. .A207)

a. An overview of the work to be performed at the components of the group, including the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, and the nature of the group auditor's planned involvement in the work to be performed by component auditors (Ref: par. .A208)

b. Instances when the group auditor's review of the work of a component auditor gave rise to a concern about the quality of that component auditor's work and how the group auditor addressed the concern

c. Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information

d. Fraud or suspected fraud involving group management, component management, employees at entities or business units who have significant roles in the group's system of internal control, or others at entities or business units in which a material misstatement of the group financial statements has or may have resulted from fraud

Communication of Identified Deficiencies in Internal Control

.76 In applying section 265, *Communicating Internal Control Related Matters Identified in an Audit*, the group auditor should determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor should consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph .47*g*. (Ref: par. .A209)

Documentation

.77 In accordance with section 230,[25]the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying section 230,[26]the group auditor should include in the audit documentation the following: (Ref: par. .A210–.A212, .A222–.A225)

a. Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed

b. The basis for the group auditor's determination of components for purposes of planning and performing the group audit (Ref: par. .A213)

c. The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor

d. The basis for the group auditor's determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components (Ref: par. .A214)

e. Key elements of the understanding of the group's system of internal control in accordance with paragraph .32*c*

[25]Paragraph .08 of section 230.

[26]Paragraphs .01–.03, .09–.12, .A8–.A9, and the exhibit in section 230.

f. The nature, timing, and extent of the group auditor's direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph .49 (Ref: par. .A215–.A221)

g. Matters related to communications with component auditors, including

   i. matters, if any, related to fraud, related parties, or going concern communicated in accordance with paragraph .34 and

   ii. matters relevant to the group auditor's conclusion with regard to the group audit, in accordance with paragraph .47, including how the group auditor has addressed significant matters discussed with component auditors, component management, or group management.

h. Those components for which reference to the audit of referred-to auditors is made in the auditor's report on the group financial statements, including the following for such components:

   i. The financial statements of the component and the auditor's report of the referred-to auditor thereon

   ii. When the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the referred-to auditor met the relevant requirements of GAAS

   iii. The basis for the group auditor's determination that referred-to auditors have the appropriate competence and capabilities

   iv. Matters related to communications with referred-to auditors communicated in accordance with paragraphs .62*c* and .63, including how the group auditor has addressed significant matters discussed with referred-to auditors, component management, or group management

i. Those components for which the group auditor uses audited financial statements of a noncontrolled entity that is accounted for by the equity method as sufficient appropriate audit evidence regarding the noncontrolled entity's financial results

j. The group auditor's evaluation of, and response to, findings or conclusions of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements

Application and Other Explanatory Material

Scope of This section (Ref: par. .01–.02)

.A1 This section also addresses the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in section 220, including for the direction and supervision of component auditors and the review of their work.

.A2 QM section 10, *A Firm's System of Quality Management*, addresses the engagements for which an engagement quality review is required to be performed. QM section 20, *Engagement Quality Reviews*, addresses the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.

.A3 An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This section applies to an audit of the group financial statements of such sub-groups performed for legal, regulatory, or other reasons. When the group auditor is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements (for example, when auditing a governmental entity), the auditor is responsible for reporting on each audit engagement in accordance with AU-C sections.

.A4 A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of *group financial statements* because they include the financial information of more than one entity or business unit through a consolidation process.

.A5 In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (for example, in a subledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (for example, divisions) for purposes of this section.

Groups and Components (Ref: par. .05–.06)

.A6 The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product, service (or by groups of products or services), or geographic locations for management or reporting purposes.

.A7 The group auditor may determine that the financial statements of an entity meet the definition of *group financial statements*; however, based on the understanding of the group's organizational structure and information system, the group auditor may determine it is appropriate to consider the financial information of certain entities or business units together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component. Therefore, the audit is a group audit even when the group auditor identifies only one component. In this scenario, this section applies (for example, even if the group auditor has identified only one component, the requirements in paragraph .40 related to designing and performing further audit procedures to respond to the assessed risks of material misstatement arising from the consolidation process are relevant). (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios.")

.A8 A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example, through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.

.A9 Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.[27]

Involvement of Component Auditors (Ref: par. .08–.09)

.A10 Component auditors may perform an audit of the financial statements of a component, whether for legal, regulatory, or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, component auditors may adapt the work performed on the audit of the component financial statements to also meet the needs of the group auditor. In any event, the requirements of this section apply, including those relating to the direction and supervision of component auditors and the review of their work.

.A11 In accordance with section 220,[28]the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. Paragraph .A86 provides examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work and may be helpful in circumstances when the group auditor plans to use the audit work from an audit of component financial statements that has already been completed.

.A12 As explained in section 200,[29]detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to

[27]See, for example, FASB ASC 280, *Segment Reporting*.

[28]Paragraph .30*b* of section 220.

[29]Paragraph .A47 of section 200.

an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the maintenance of professional skepticism, and the supervision and review of the audit work performed.

.A13 Detection risk is a broader concept than aggregation risk as described in paragraphs .16 and .A20. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

Professional Skepticism (Ref: par. .11)

.A14 Section 220[30]provides examples of the impediments to the maintenance of professional skepticism at the engagement level, including unconscious auditor biases that may impede the maintenance of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Section 220 also provides possible actions that the engagement team may take to mitigate impediments to the maintenance of professional skepticism at the engagement level.

.A15 Requirements and relevant application material in section 315,[31]section 540, *Auditing Accounting Estimates and Related Disclosures*,[32]and other AU-C sections address the maintenance of professional skepticism and include examples of how documentation may help provide evidence of the auditor's maintenance of professional skepticism.

.A16 All members of the engagement team are required to maintain professional skepticism throughout the group audit. The group auditor's direction and supervision of engagement team members, including component auditors, and the review of their work, may inform the group auditor about whether the engagement team has appropriately maintained professional skepticism.

.A17 The maintenance of professional skepticism in a group audit may be affected by matters such as the following:

- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.
- The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*,[33]and therefore may require

[30]Paragraphs .A34–.A36 of section 220.

[31]Paragraph .A268 of section 315.

[32]Paragraph .A11 of section 540, *Auditing Accounting Estimates and Related Disclosures.*

additional time or expertise to understand the business purpose and activities of certain entities or business units.

- The nature and extent of intragroup transactions (for example, transactions that involve multiple entities and business units within the group or multiple related parties), cash flows, or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
- When the group audit is subject to tight reporting deadlines, this may put pressure on engagement team members when completing the work assigned. In these circumstances, the engagement team may need to take additional time to appropriately question management's assertions, make appropriate judgments, or appropriately review the audit work performed.

.A18 The maintenance of professional skepticism by the group auditor includes remaining alert for inconsistent information from component auditors, component management, and group management about matters that may be significant to the group financial statements.

Responsibilities of the Group Engagement Partner and Group Auditor (Ref: par. .13)

.A19 Component auditors may perform work on the financial information of the components for the group audit, or reference may be made to the audit of a referred-to auditor in the auditor's report on the group financial statements and, as such, component auditors and referred-to auditors are responsible for their overall findings or conclusions. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

Definitions

Aggregation Risk (Ref: par. .16)

.A20 Aggregation risk exists in all audits of financial statements but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances, or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components at which audit procedures are performed separately increases, whether by component auditors or other members of the engagement team.

Component (Ref: par. .16)

.A21 The group auditor uses professional judgment in determining components at which audit work will be performed considering, for example, the understanding of the group obtained in accordance with paragraph .32, including the understanding of the financial reporting framework and the consistency of accounting policies and practices across the

[33]Appendix A of section 240, *Consideration of Fraud in a Financial Statement Audit.*

group. Paragraph .A7 explains that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements encompasses all the entities and business units whose financial information is included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .16)

.A22 In audits of state and local governments, a component may be a separate legal entity reported as a component unit or as part of the governmental entity, such as a business activity, department, or program.

Component Auditor (Ref: par. .16)

.A23 References in this section to the *engagement team* include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (for example, another office within the group auditor's firm).

.A24 An auditor who performs work on a component when the group auditor will not use that work to provide audit evidence for the group audit is not considered a component auditor.

.A25 In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances, or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

.A26 Paragraph .26 requires the group auditor to request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. Paragraph .A68 provides guidance for circumstances in which the component auditor is unable to provide such a confirmation.

Component Management (Ref: par. .16)

.A27 *Component management* refers to management responsible for the financial information or other activity (for example, processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs .A7–.A8), *component management* refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management, and group management may be directly responsible for the financial information or other activities of the component.

Group Engagement Partner (Ref: par. .16)

.A28 When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the *group engagement partner* and *engagement team* for the purposes of GAAS. This section does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

Group Financial Statements (Ref: par. .02, .16)

.A29 The requirements for the preparation and fair presentation of the group financial statements may be specified in the applicable financial reporting framework, which may therefore affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (for example, subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that are under common control or entities under common management.

.A30 The term *consolidation process* as used in this section is not intended to have the same meaning as *consolidation* or *consolidated financial statements* as defined or described in financial reporting frameworks. Rather, consolidation process refers more broadly to the process used to prepare group financial statements.

.A31 The detailed aspects of the consolidation process vary from one group to another, depending on the group's structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .01, .17)

.A32 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit (Ref: par. .13, .18)

.A33 It may not be possible or practical for the group engagement partner to solely deal with all requirements in section 220, particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement level, section 220[24]permits the engagement partner to assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks, or actions to other members of the engagement team, and these members may assign procedures, tasks, or actions further. In such circumstances, section 220 requires that the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement.

.A34 Policies or procedures established by the firm, or that are common network requirements or network services,[35]may support the group engagement partner by facilitating communication between the group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.

.A35 Section 220[36]explains that a culture that demonstrates a commitment to quality is shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph .18*a*, the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (for example, leading by example).

Acceptance and Continuance

Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained (Ref: par. .19–.20)

.A36 In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as the following:

- The group structure, including both the legal and organizational structure
- Activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place
- The use of service organizations
- The use of shared service centers
- The consolidation process
- Whether the group auditor
  - — will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, and component information, including of those components that are accounted for by the equity method, and

[24]Paragraph .15 of section 220.

[35]Paragraphs .49–.53 of QM section 10, *Engagement Quality Reviews*.

[36]Paragraph .A28 of section 220.

  - — will be able to perform necessary work on the financial information of the components when applicable

- Whether sufficient and appropriate resources are assigned or will be made available

.A37 In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph .A36 may be obtained from

- information provided by group management,
- communication with group management,
- communication with those charged with governance of the group, and
- when applicable, communication with component management or the predecessor auditor.

.A38 For a recurring engagement, the ability to obtain sufficient appropriate audit evidence may be affected by significant changes in, for example, the following:

- The group structure (for example, acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized)
- Components' activities that are significant to the group
- The composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed
- The group auditor's understanding of the integrity and competence of group or component management
- Changes in the applicable financial reporting framework

.A39 There may be additional complexities with obtaining sufficient appropriate audit evidence in a group audit when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. For example, law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest, or outbreaks of disease may restrict the group auditor's access to relevant component auditor audit documentation. Paragraph .A223 includes possible ways to address these situations.

.A40 In addition to the work performed by the group auditor, the group engagement partner may obtain sufficient appropriate audit evidence regarding the financial information of one or more components through using the work of a component auditor or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

.A41 There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, including in group audits where no component auditors are also involved. The group engagement partner may consider the nature and extent of work to be performed by referred-to auditors, including matters such as the following:

- The risks of material misstatement to the group financial statements associated with the portion of the entity's financial statements for which the group auditor or component auditor performs audit procedures compared to the portion audited by referred-to auditors
- The importance to the group of the components audited by referred-to auditors, considering quantitative and qualitative factors

More complexity in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained may indicate an area of significant judgment for which the group engagement partner is required to review the audit documentation related to the significant judgment,[37]including the conclusions reached.[38]For example, the group engagement partner may identify as a significant judgment the determination that sufficient appropriate audit evidence can reasonably be expected to be obtained through making reference to the audit of referred-to auditors in the auditor's report on the group financial statements when the portion of the group financial statements audited by referred-to auditors is quantitatively or qualitatively significant.

.A42 Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting

- the group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit documentation sought by the group auditor) (see paragraphs .22–.23), or
- the work to be performed on the financial information of components.

Paragraphs .A52–.A53 explain the possible effect of such restrictions on the auditor's report on the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .19)

.A43 In audits of state and local governments, when reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, the following are additional factors to consider in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained:

- Engagement by the primary government as the auditor of the financial reporting entity

[37]Paragraph .31 and .A93 of section 220.

[38]Paragraph .08 of section 230.

- Responsibility for auditing the primary government's general fund (or other primary operating fund)

Agreeing the Terms of Audit Engagements (Ref: par. .21)

.A44 Section 210[39]requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. The terms of engagement identify the applicable financial reporting framework.[40]Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a referred-to auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communications between the group auditor and component auditors, to the extent permitted by laws or regulations
- Communications to the group auditor of important communications between
  - — component auditors and those charged with governance of the component or component management, including communications on significant deficiencies and material weaknesses in internal control and
  - — regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit
- Permission for the group auditor to perform work, or request a component auditor to perform work, at the component

Restrictions on Access to Information or People (Ref: par. .22–.23)

.A45 Restrictions on access to information or people do not eliminate the requirement for the group auditor to obtain sufficient appropriate audit evidence.

.A46 Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations, or other conditions, for example, war, civil unrest, or outbreaks of disease. Paragraph .A223 describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.

.A47 In some circumstances, the group auditor may be able to overcome restrictions on access to information or people. Examples follow:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.

[39]Paragraph .09 of section 210, *Terms of Engagement*.

[40]Paragraph .10*e* of section 210.

- If the group has a noncontrolling interest in an entity that is accounted for by the equity method for which the group auditor is neither making reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements (see paragraphs .A66 and .A175), nor using audited financial statements of the noncontrolled entity as sufficient appropriate audit evidence regarding the noncontrolled entity's financial results (see paragraphs .66, .A66, and .A188–.A190), the group auditor may do the following:
  - — Determine whether provisions exist (for example, in the terms of joint venture agreements or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights
  - — If the group has representatives who are on the executive board or are members of those charged with governance of the noncontrolled entity, inquire whether they can provide financial and other information available to them in these roles

.A48 If the group has a noncontrolling interest in an entity that is accounted for by the equity method for which the group auditor is neither making reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements (see paragraphs .A66 and .A175), nor using audited financial statements of the noncontrolled entity as sufficient appropriate audit evidence regarding the noncontrolled entity's financial results (see paragraphs .66, .A66, and .A188–.A190), and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example, from the following:

- Financial information that is available from group management because group management also needs to obtain the noncontrolled entity's financial information in order to prepare the group financial statements
- Publicly available information, such as public disclosure documents or quoted prices of equity instruments in the noncontrolled entity

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.[41]

.A49 If the group has a noncontrolling interest in an entity that is accounted for by the equity method and access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

.A50 When the group auditor is unable to obtain sufficient appropriate audit evidence due to restrictions on access to information or people, the group auditor may

[41] Paragraph .07*b* of section 330.

- communicate the restrictions to the group auditor's firm to assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may communicate with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest, or outbreaks of disease in a major economy.
- be required by law or regulation to communicate with regulators, listing authorities, or others about the restrictions.

.A51 Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions call into question group management's integrity.

Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements (Ref: par. .22–.23)

.A52 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, contains requirements and guidance about how to address situations when the group auditor is unable to obtain sufficient appropriate audit evidence. Illustration 1 in exhibit B, "Illustrative Auditor's Reports on Group Financial Statements," contains an example of an auditor's report containing a qualified group audit opinion based on the group auditor's inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

Law or Regulation Prohibits the Group Engagement Partner From Declining or Withdrawing From an Engagement (Ref: par. .22–.23)

.A53 Section 210 addresses circumstances when an entity is required by law or regulation to have an audit. In these circumstances, this section still applies to the group audit, and the effect of the group auditor's inability to obtain sufficient appropriate audit evidence is addressed in section 705.

Overall Group Audit Strategy and Group Audit Plan

The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: par. .24)

.A54 As explained in section 300,[42]planning is not a discrete phase of an audit but, rather, a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing, and extent of further audit procedures, based on the revised

[42]Paragraph .A2 of section 300.

consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the nature, timing, and extent of the component auditors' involvement. Section 300[43]requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

.A55 The form of the group audit strategy and group audit plan may vary based on the nature and circumstances of each group audit engagement, including the extent to which engagement management is integrated into the audit tools used for the group audit. An electronic audit tool may be used to develop and update the group audit strategy and audit plan and facilitate the group engagement partner's review of the group audit plan and group audit strategy.

Establishing the Overall Group Audit Strategy and Group Audit Plan (Ref: par. .24)

.A56 In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework, and the entity's system of internal control based on information obtained from group management, those charged with governance of the group and, when applicable, communication with component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through prior period audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant.

.A57 The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.

.A58 The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances, and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a preliminary determination of matters such as the following:

- Whether to perform audit work centrally, at components, or a combination thereof
- The nature, timing, and extent of audit work to be performed with respect to the financial information of components (for example, design and perform risk assessment procedures, further audit procedures, or a combination thereof) (see paragraph .A146)
- The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor

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[43]Paragraph .10 of section 300.

Components at Which to Perform Audit Work (Ref: par. .24a)

.A59 The determination of components at which to perform audit work is a matter of professional judgment. The following are examples of matters that may influence the group auditor's determination:

- The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example
  - — newly formed or acquired entities or business units,
  - — entities or business units in which significant changes have taken place,
  - — significant transactions with related parties,
  - — significant unusual transactions, and
  - — abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with section 315[44]
- The disaggregation of significant classes of transactions, account balances, and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities, and transactions at the location or business unit relative to the group financial statements
- The assessed risks of material misstatement of the group financial statements that exist at a component, and whether such risks are higher or exist at more than one component
- Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances, and disclosures in the group financial statements from audit work planned on the financial information of identified components
- The nature and extent of misstatements or control deficiencies identified at a component in prior period audits
- The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting

Considerations Specific to Governmental Entities (Ref: par. .24a)

.A60 In audits of governmental entities, the following are examples of matters that may influence the group auditor's determination of components at which to perform audit work:

- The disaggregation of significant classes of transactions, account balances, and disclosures (for example, net costs or total budget) in the group financial statements across components, considering the size and nature of assets, liabilities, and

[44] Paragraph .14*b* of section 315.

transactions, at the component unit, business activity, department, or program relative to the group financial statements

- The materiality of the component relative to its related opinion unit as set forth in AICPA Audit and Accounting Guide *State and Local Governments*
- Matters of heightened public sensitivity, such as national security issues, donor-funded projects, or reporting of tax revenue

Resources (Ref: par. .24b)

.A61 Matters that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing, and extent to which component auditors are to be involved are a matter of professional judgment. The following are examples of such matters:

- The understanding of the group, the components within the group at which audit work is to be performed, and whether to perform work centrally, at components, or a combination thereof.
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group auditor of the local industries in which components operate, local laws or regulations, business practices, language, and culture. In addition, the involvement of auditor's specialists may be needed on complex matters.
- The initial expectations about the potential risks of material misstatement.
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may affect the need to involve component auditors in specific locations.
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved.
- The nature of the components' activities, including their complexity or specialization of operations.
- The group's system of internal control, including the information system in place and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized.
- Previous experience with the component auditor.

.A62 Component auditors may be involved in different phases of an audit. For example, component auditors may design or perform

- risk assessment procedures, or
- procedures to respond to the assessed risks of material misstatement.

.A63 The nature, timing, and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often, component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements.

.A64 Section 300[45]requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of component auditors in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit relative to particular components. This may be affected by the nature, timing, and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.

.A65 As described in QM section 10,[46]there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including, when applicable, their allocation to component auditors, and the extent to which they relate to the resources required, may be a special consideration for group audit engagements. For example, in a group audit, the firm's financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement of component auditors. In such circumstances, these constraints do not alleviate the group engagement partner's responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

.A66 If the group has a noncontrolling interest in an entity that is accounted for by the equity method and audited financial statements of the noncontrolled entity are available, the group auditor may determine to use such audited financial statements as audit evidence regarding the noncontrolled entity's financial results, for example (Ref: par. .24*d*)

- in applying the requirements in paragraphs .51–.65, the group engagement partner may determine to make reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements, or
- in applying the guidance in paragraphs .A188–.A190, the group auditor may determine that the audited financial statements of the noncontrolled entity provide

[45]Paragraph .05 of section 300.

[46]Paragraph .A78 of QM section 10.

sufficient appropriate audit evidence regarding the noncontrolled entity's financial results. In this situation, the requirements in paragraph .66 regarding using audited financial statements of the noncontrolled entity as sufficient appropriate audit evidence regarding the noncontrolled entity's financial results are applicable.

If audited financial statements of the noncontrolled entity are not available, or, in applying the guidance in paragraphs .A188–.A190, the group auditor determines that the audited financial statements of the noncontrolled entity do not provide sufficient appropriate audit evidence regarding the noncontrolled entity's financial results, the requirements in this section regarding obtaining sufficient appropriate audit evidence regarding the noncontrolled entity's (that is, a component's) financial results, without making reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements, are applicable (see paragraph .A191).

Considerations When Component Auditors Are Involved

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: par. .25–.26)

.A67 In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.

.A68 If the component auditor is unable to cooperate with the group auditor, the group auditor may do the following:

- Request the component auditor to provide its rationale.
- Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed. Alternatively, in accordance with paragraph .29, the group auditor may need to obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. .27)

.A69 When performing work at a component for a group audit engagement, the component auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include due care. Due care requires the auditor to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the audit.[47] Such requirements may be different from or in addition to those applying to the component auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the component auditor's jurisdiction. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements, including those related to professional competence and due care, set forth in the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* is sufficient to fulfill the component auditor's ethical responsibilities in the group audit. [Revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

.A70 In making the component auditor aware of relevant ethical requirements, the group auditor may consider whether additional information or training for component auditors is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: par. .28)

.A71 Section 220[48]requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management, or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

Competence and Capabilities of the Component Auditor

.A72 Section 220[49]provides guidance regarding matters the engagement partner may take into consideration when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit when the engagement team includes component auditors. Section 220[50]indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor from another firm has the appropriate competence and capabilities to perform the audit engagement.

.A73 Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement. This determination influences the nature, timing, and extent of the group engagement partner's direction and supervision of the component auditor and the review of their work.

.A74 In determining whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component, the group engagement partner may consider matters such as the following:

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[47]Paragraph .A16 and .A19 of section 200.

[48]Paragraph .25 of section 220.

[49]Paragraph .A71 of section 220.

[50]Paragraph .A24 of section 220.

- Previous experience with or knowledge of the component auditor
- The component auditor's specialized skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
- The component auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS, that is sufficient to fulfill the component auditor's responsibilities
- The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and the component auditor
  - — use common resources to perform the work (for example, audit methodologies or IT applications),
  - — share common policies or procedures affecting engagement performance (for example, direction, supervision, and review of work or consultation),
  - — are subject to common monitoring activities, or
  - — have other commonalities, including common leadership or a common cultural environment
- The consistency or similarity of
  - — laws or regulations or legal system;
  - — language and culture;
  - — education and training;
  - — professional oversight, discipline, and external quality assurance; or
  - — professional organizations and standards
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors

.A75 The procedures to determine the component auditor's competency and capability may include, for example, the following:

- An evaluation of the information communicated by the group auditor's firm to the group auditor, including
  - — the firm's ongoing communication related to monitoring and remediation, in circumstances when the group auditor and component auditor are from the same firm[51]

[51]Paragraph .48 of QM section 10.

    - information from the network about the results of the monitoring activities undertaken by the network across the network firms[52]
    - information obtained from professional bodies to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties

- Discussing the assessed risks of material misstatement with the component auditor
- Requesting the component auditor to confirm its understanding of the matters referred to in paragraph .27 in writing
- Discussing the component auditor's competence and capabilities with colleagues in the group engagement partner's firm that have worked directly with the component auditor
- Obtaining published external inspection reports, peer review reports on the component auditor's firm, and other relevant publicly available information relating to the professional reputation and standing of a component auditor

.A76 The group engagement partner's firm and the component auditor may be members of the same network and may be subject to common network requirements or use common network services.[53]When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with QM section 10,[54]the firm is responsible for designing, implementing, and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

Using the Work of an Auditor's Specialist

.A77 Section 220[55]requires the engagement partner to determine that members of the engagement team, and any auditor's external specialists who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If an auditor's specialist is used by a component auditor, the group engagement partner may need to obtain information from the component auditor. For example, the group auditor may discuss with the component auditor, the component auditor's evaluation of the competence and capabilities of the auditor's specialist.

[52]Paragraph .52*b* of QM section 10.

[53]Paragraphs .A20 and .A188 of QM section 10.

[54]Paragraphs .49–.50 of QM section 10.

[55]Paragraph .26 of section 220.

Automated Tools and Techniques

.A78 When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools and techniques. For example, as described in section 220,[56]when the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may communicate with component auditors that the use of such automated tools and techniques need to comply with the group auditor's instructions.

Application of the Group Auditor's Understanding of a Component Auditor (Ref: par. .29)

.A79 Section 220[57]requires the engagement partner to take responsibility for other members of the engagement team, having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures. This includes the firm's policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm's policies or procedures also may address breaches of independence requirements by component auditors and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.[58]

.A80 If there has been a breach by a component auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot use the work of that component auditor.

.A81 Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less-than-serious concerns about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by the group auditor being more involved in the work of the component auditor or by directly performing further audit procedures on the financial information of the component.

Engagement Performance (Ref: par. .30)

.A82 Section 220[59]requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and

[56]Paragraph .A65 of section 220.

[57]Paragraph .17 of section 220.

[58]Paragraph .A17 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[59]Paragraph .30 of section 220.

regulatory requirements and is responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team. For a group audit, the approach to direction, supervision, and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement-specific responses.

.A83 For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the group engagement partner in fulfilling the responsibility for the nature, timing, and extent of the direction and supervision of component auditors and the review of their work (see also paragraph .13).

.A84 If component auditors are from a firm other than the group auditor's firm, the firm's policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing, and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (for example, in relation to the form, content, and timing of communications with component auditors, including the use of group auditor instructions to component auditors). Section 220 provides examples of actions that may need to be taken in such circumstances.[60]

.A85 The nature, timing, and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example, the following factors:

- The assessed risks of material misstatement. For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor's audit documentation may be appropriate.
- The competence and capabilities of the component auditors performing the audit work. For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
- The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when service delivery centers are used.
- Access to component auditor audit documentation. For example, when law or regulation precludes component auditor audit documentation from being transferred out of the component auditor's jurisdiction, the group auditor may be able to

[60]Paragraphs .A24–.A25 of section 220.

review the audit documentation at the component auditor's location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs .A222–.A223).

.A86 The following are examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work:

- Communications with component auditors throughout the course of the group audit, including communications required by this section
- Meetings or calls with component auditors to discuss identified and assessed risks, findings or issues, and conclusions
- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation
- Participating in closing or other key meetings between the component auditors and component management

.A87 In applying section 220,[61] the group engagement partner is required to review audit documentation at appropriate points in time during the audit engagement, including audit documentation relevant to the group audit relating to

- significant matters;
- significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

The group engagement partner's identification of areas of significant judgment made by component auditors[62] involves the exercise of professional judgment. Audit documentation related to communications with component auditors, such as those indicated in paragraphs .47–.49 of this section, may assist with fulfilling the requirement in paragraph .31 of section 220. The review of such audit documentation by the group engagement partner often takes place during the course of the group audit, including the review of relevant component auditor audit documentation (also see paragraph .A163). The group engagement partner exercises professional judgment in determining the nature and extent of the review of component auditor audit documentation.[63]Such review may constitute reviewing component auditor communications.

Communications With Component Auditors (Ref: par. .31)

.A88 Clear and timely communication between the group auditor and the component auditors about their respective responsibilities, along with clear direction to the component

[61]Paragraphs .31 and .A92–.A93 of the section 220.

[62]Paragraph .A93 of section 220.

[63]Paragraph .A91 of section 220.

auditors about the nature, timing, and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor's direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to maintain professional skepticism in the work performed for purposes of the group audit.

.A89 The following are examples of other factors that may also contribute to effective two-way communication:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor's firm.
- A mutual understanding that the component auditor may discuss the audit work requested to be performed, based on the component auditor's knowledge and understanding of the component.
- A mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form of communications. For example, matters that need timely attention may be more appropriately discussed in a meeting, rather than by exchanging emails.
- A mutual understanding of the persons from the group auditor and component auditors who have responsibility for managing communications regarding particular matters.
- The process for the component auditor to take action and report back on matters communicated by the group auditor.

.A90 The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

Form of Communications

.A91 The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

.A92 The form of communications also may be affected by such factors as the following:

- The significance, complexity, or urgency of the matter

- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group
- Whether the group auditor and component auditor are from the same firm or network firms

.A93 Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor's verbal communications with the component auditors may be supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet with the component auditor to discuss significant matters or to review relevant parts of the component auditor's audit documentation.

.A94 Paragraph .47 requires the group auditor to request of the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. As explained in paragraph .A161, the form and content of the component auditor's deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.

.A95 Regardless of the form of communications between the group auditor and component auditors, the documentation requirements of this section and other AU-C sections apply.

Timing of Communications

.A96 The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing, and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Noncompliance With Laws or Regulations (Ref: par. .27, .31)

.A97 In applying section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, the group engagement partner may become aware of information about noncompliance or suspected noncompliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws, or regulations to communicate the matter to the component auditor.[64]

[64] See, for example, paragraphs .22–.23 of the "Responding to Noncompliance With Laws and Regulations" interpretation (ET sec. 1.180.010) of the AICPA Code of Professional Conduct.

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control (Ref: par. .32)

.A98[65]contains requirements and guidance regarding the auditor's responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. Appendix A, "Understanding the Group's System of Internal Control," of this section provides examples of matters related to controls that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment and expands on how section 315A is to be applied to an audit of group financial statements.

.A99 The group auditor's understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control with respect to the components for which a referred-to auditor performs an audit may vary as compared to the components for which a component auditor performs audit procedures.

.A100 The understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control may be obtained through communications with

- group management, component management, or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group's system of internal control, accounting policies and practices, and the consolidation process;
- component auditors or referred-to auditors; or
- auditors that perform an audit for legal, regulatory, or other reasons of the financial statements of an entity or business unit that is part of the group.

.A101 Obtaining an understanding of the group, identifying risks of material misstatement, and assessing inherent risk and control risk may be performed in different ways depending on preferred audit techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may communicate its preferred approach with component auditors or provide instructions.

Engagement Team Discussion (Ref: par. .32)

.A102 In applying section 315,[66] the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the group's financial statements to material misstatement. The group engagement partner's determination of which members of the engagement team to include in the discussion and the topics to be discussed is affected

[65]Paragraphs .19–.31 and .A58–.A212 of section 315A.

[66]Paragraph .17 of section 315.

by matters such as initial expectations about the risks of material misstatement and the preliminary expectation of whether to involve component auditors.

.A103 The discussion provides an opportunity to do the following:

- Share knowledge of the components and their environments, including which components' activities are centralized.
- Exchange information about the business risks of the components or the group and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances, and disclosures.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. Section 240[67]requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.
- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting.
- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.
- Consider the risk that group or component management may override controls.
- Discuss fraud that has been identified or information that indicates existence of fraud.
- Identify risks of material misstatement relevant to components in which there may be impediments to the maintenance of professional skepticism.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components.
- Share information that may indicate noncompliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.
- Discuss events or conditions identified by group management, component management, or the engagement team that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time.

[67]Paragraph .15 of section 240.

- Discuss related party relationships or transactions identified by group management or component management and any other related parties of which the engagement team is aware.

The Group and Its Environment (Ref: par. .32a)

.A104 An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as the following:

- *The complexity of the group's structure.*A group may be more complex than a single entity because a group may have several subsidiaries, divisions, or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures, or variable interest entities are accounted for appropriately and whether adequate disclosures have been made.
- *The geographic locations of the group's operations.*Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve different languages, cultures, and business practices.
- *The structure and complexity of the group's IT environment.* A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.
- *Relevant regulatory factors, including the regulatory environment.* Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- *The ownership, and relationships between owners and other people or entities, including related parties.* Understanding the ownership and relationships can be more complex in a group that operates across multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposal, or joint venture. These factors may give rise to increased susceptibility to material misstatements.

.A105 Obtaining an understanding of the degree to which the group's operations or activities are similar may help to identify similar risks of material misstatement across components and design an appropriate response.

.A106 The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group's entities and business units and take action. The understanding of such performance measures may help to identify

- areas where there is increased susceptibility to material misstatements (for example, due to pressures on component management to meet certain performance measures).
- controls over the group's financial reporting process.

The Group's System of Internal Control

The Nature and Extent of Commonality of Controls (Ref: par. .32c(i))

.A107 Group management may design controls that are intended to operate in a common manner across multiple entities or business units (that is, common controls). For example, group management may design common controls for inventory management, which operate using the same IT system and are implemented across all entities or business units in the group. Common controls may exist in each component of the group's system of internal control, and they may be implemented at different levels within the group (for example, at the level of the consolidated group as a whole or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. *Direct controls* are controls that are precise enough to address risks of material misstatement at the assertion level. *Indirect controls* are controls that support direct controls.[68]

.A108 Understanding the components of the group's system of internal control includes understanding the commonality of tasks and actions, structures, processes, or controls within those components across the group. In understanding the commonality of a control across the group, considerations that may be relevant include whether

- the control is designed centrally and is required to be implemented as designed (that is, without modification) at some or all components;
- the control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
- if a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
- if the control is automated, it is configured in the same way in each IT application across the components.

.A109 Judgment may often be needed to determine whether a control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that is generated from a specific IT application. When the aging reports are generated from different IT applications or the

[68]Paragraph .A5 of section 315.

implementation of the IT application differs across entities or business units, there may be a need to consider whether the control can be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (for example, whether the IT application is configured in the same manner across components and whether there are effective general IT controls across different IT applications).

.A110 Consideration of the level at which controls are performed within the group (for example, at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances, controls may be performed centrally (for example, performed only at a single entity or business unit) but may have a pervasive effect on other entities or business units (for example, a shared service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center, regardless of the entity or business unit (for example, the processes, risks of material misstatement, and controls may be the same, regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

Centralized Activities (Ref: par. .32c(i)–(ii))

.A111 Group management may centralize some of its activities. For example, financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (for example, when the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).

.A112 Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (for example, sales transactions may be initiated and authorized at an entity or business unit, but the processing may occur at the shared service center).

.A113 The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration between the group auditor and component auditors is important because the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the determination of the nature, timing, and extent of substantive procedures to be performed across the group.

Communications About Significant Matters That Support the Preparation of the Group Financial Statements (Ref: par. .32c(iv))

.A114 Entities or business units may use a financial reporting framework for legal, regulatory, or other reasons that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations, and reclassifications are made and whether they are made centrally by group management or by the entity or business unit.

Instructions by Group Management to Entities or Business Units

.A115 In applying section 315,[69]the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (for example, communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. Obtaining an understanding of group management's instructions may affect the identification and assessment of the risks of material misstatement of the group financial statements. For example, inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly or inconsistently applied.

.A116 The group auditor's understanding of the instructions or policies may include the following:

- The clarity and practicality of the instructions for completing the reporting package
- Whether the instructions
  - — adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
  - — address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
  - — address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
  - — include a reporting timetable.

[69]Paragraph .25*b* of section 315.

Considerations When Component Auditors Are Involved in Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control (Ref: par. .33–.34)

.A117 During the course of the group audit, the group auditor may communicate the matters in paragraph .33 to other component auditors, if these matters are relevant to the work of those component auditors. Paragraph .A159 includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

.A118 The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.[70]In a group audit, there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships when

- the group structure is complex;
- the group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- there are numerous or frequent related party transactions between entities and business units.

Planning and performing the audit with professional skepticism, as required by section 200,[71]is therefore particularly important when these circumstances exist.

.A119 A component auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph .33*b* to communicate to any other component auditors those related party relationships or transactions if they are relevant to the work of the other component auditors.

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .35)

.A120 The process to identify and assess the risks of material misstatement of the group financial statements is iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized or when there are many components across multiple locations. In applying section 315,[72]the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances, and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control.

.A121 The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business

[70]Paragraph .03 of section 550.

[71]Paragraph .17 of section 200.

[72]Paragraph .A143 of section 315.

units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures because they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.

.A122 For identified risks of material misstatement at the assertion level, the group auditor is required to take responsibility for assessing inherent risk. Such assessment involves assessing the likelihood and magnitude of misstatement, which takes into account how, and the degree to which[73]

- inherent risk factors affect the susceptibility of relevant assertions to misstatement.
- the risks of material misstatement at the group financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.

.A123 Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in entities or business units that have similar operations or activities.

.A124 Appendix B, "Examples of Events or Conditions That May Give Rise to Risks of Material Misstatement of the Group Financial Statements," of this section sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process.

Fraud

.A125 In applying section 240,[74]the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud and to design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify and assess the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risk that the group financial statements may be materially misstated due to fraud
- Group management's process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group

[73]Paragraph .35 of section 315.

[74]Paragraphs .26 and .31 of section 240.

management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher

- Whether there are particular components that are more susceptible to risks of material misstatement due to fraud
- Whether any fraud risk factors or indicators of management bias exist in the consolidation process
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor's inquiry about whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

Considerations When Component Auditors Are Involved (Ref: par. .36)

.A126 Regardless of whether component auditors are involved in the design and performance of risk assessment procedures, paragraph .39 of section 315 is applicable. When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph .35.

.A127 When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, section 315[75]requires the auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

Materiality

Component Performance Materiality (Ref: par. .37a)

.A128 Paragraph .37*a* requires the group auditor to determine component performance materiality for each of the components where the group auditor or component auditor will perform audit procedures on financial information that is disaggregated. The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

[75]Paragraph .39 of section 315.

.A129 This section does not require component performance materiality to be determined for components that are audited by referred-to auditors and for which the group auditor plans to make reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

.A130 This section does not require component performance materiality to be determined for each class of transactions, account balance, or disclosure for components at which audit procedures are performed. However, if in the specific circumstances of the group, there is one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, section 320[76]requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures. In these circumstances, the group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances, or disclosures.[77]

.A131 The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (for example, as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (for example, if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example
  - — whether there are risks that are unique to the financial information of the component (for example, industry-specific accounting matters, or unusual or complex transactions)
  - — the nature and extent of misstatements identified at the component in prior audits

.A132 To address aggregation risk, paragraph .37*a* requires component performance materiality to be lower than group performance materiality. As explained in paragraph .A131, as the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents

[76]Paragraphs .10 and .A13–.A14 of section 320.

[77]Paragraph .A15 of section 320.

a substantial portion of the group financial statements. When determining component performance materiality for a noncontrolling interest in an entity that is accounted for by the equity method and for which the group auditor or component auditor will perform audit procedures, the group auditor may take into account the group's ownership percentage and the share of the investee's profits and losses.

.A133 In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (that is, not disaggregated across components). In such cases, group performance materiality often will be used for purposes of performing these procedures.

.A134 When the component is subject to an audit required by law or regulation or performed for another reason, the performance materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group performance materiality and, accordingly, the lower component performance materiality would be acceptable for purposes of the group audit.

"Clearly Trivial" Threshold (Ref: par: .37b)

.A135 The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with section 450,[78]this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

Considerations When Component Auditors Are Involved

Communicating Component Performance Materiality (Ref: par. .38)

.A136 In some cases, it may be appropriate for the group auditor to involve the component auditor in determining an appropriate component performance materiality amount, in view of the component auditor's knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.

.A137 Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

[78]Paragraph .A3 of section 450.

Responding to the Assessed Risks of Material Misstatement (Ref: par. .39)

Performing Further Audit Procedures

Performing Further Audit Procedures Centrally

.A138 Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances, or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally (for example, at a shared service center). Factors that may be relevant to the auditor's determination of whether to perform further audit procedures centrally include

- the level of centralization of activities relevant to financial reporting,
- the nature and extent of commonality of controls, and
- the similarity of the group's activities and business lines.

.A139 The group auditor may determine that the financial information of several components can be considered as one population for the purpose of performing further audit procedures (for example, when transactions are considered to be homogeneous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way).

.A140 When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

Performing Further Audit Procedures at the Component Level

.A141 In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has

- different revenue streams,
- multiple lines of business,
- operations across multiple locations, or
- decentralized systems of internal control.

Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements

.A142 A group may comprise a large number of components whose financial information is individually immaterial but material in the aggregate to the group financial statements.

Circumstances such as these in which the significant classes of transactions, account balances, or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.

.A143 In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances, or disclosures (for example, if they are homogeneous, subject to common controls, and access to appropriate information can be obtained). Further audit procedures may also include substantive analytical procedures in accordance with section 520, *Analytical Procedures*. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.

.A144 In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of the components at which audit procedures are to be performed, and the nature, timing, and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in relation to the risks of material misstatement of the group financial statements due to fraud (also see paragraph .A151).

The Nature and Extent of Further Audit Procedures

.A145 In applying section 330,[79]the nature, timing, and extent of further audit procedures performed on the financial information of components is based on, and is responsive to, the assessed risks of material misstatement of the group financial statements. In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):

- Design and perform further audit procedures on the entire financial information of the component (for example, when a component auditor is requested to perform an audit, adapted as necessary, of the component financial information for purposes of the group audit)
- Design and perform further audit procedures on one or more classes of transactions, account balances, or disclosures
- Perform specific further audit procedures (for example, procedures designed by the group auditor)

.A146 Although the group auditor takes responsibility for the nature, timing, and extent of further audit procedures to be performed, component auditors can be and often are involved

[79]Paragraph .06 of section 330.

in all phases of the group audit, including in the design and performance of further audit procedures.

.A147 The group auditor may determine that obtaining the audit report of a referred-to auditor with respect to one or more components may be appropriate audit evidence. In that case, the group auditor follows the requirements in this section when making reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

Design and Perform Further Audit Procedures on the Entire Financial Information of the Component

.A148 The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when

- audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- there is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern for a reasonable period of time.

Design and Perform Further Audit Procedures on One or More Classes of Transactions, Account Balances, or Disclosures

.A149 The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but hold a significant portion of the land and buildings of the group or have significant tax balances.

Perform Specific Further Audit Procedures

.A150 The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may do the following:

- Centrally test the class of transaction, account balance, or disclosure and may require the component auditor to perform specific further audit procedures at the component (for example, specific further audit procedures related to the valuation of claims or litigation in the component's jurisdiction or the existence of an asset)
- Design specific further audit procedures and request the component auditor to perform those specific further audit procedures at the component (for example,

perform substantive procedures to address risks of material misstatement related to revenue), including specifying the sample sizes to be used

- Request one or more component auditors to perform tests of controls related to certain significant classes of transactions, account balances, and disclosures
- Request a component auditor to perform procedures to obtain audit evidence related to one or more relevant assertions

Element of Unpredictability

.A151 Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed, and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.[80]

Operating Effectiveness of Controls

.A152 The group auditor may rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing, and extent of substantive procedures to be performed at either the group level or at the components. Section 330[81]requires the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence regarding the operating effectiveness of those controls. Component auditors may be involved in designing and performing such tests of controls.

.A153 If deviations from controls upon which the auditor intends to rely are detected, section 330[82]requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include the following:

- Performing additional substantive procedures at certain components
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively
- Increasing the number of components selected for further audit procedures

.A154 When the operating effectiveness of controls is tested centrally (for example, controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive procedures on the entire financial information of the component, or design and perform substantive procedures on one or more classes of transactions, account balances, or

[80]Paragraph .29*c* of section 240.

[81]Paragraph .08 of section 330.

[82]Paragraph .17 of section 330.

disclosures, the component auditor may discuss with the group auditor about the control testing performed centrally to determine the nature, timing, and extent of the substantive procedures.

Consolidation Process

Consolidation Procedures (Ref: par. .40)

.A155 Further audit procedures on the consolidation process, including sub-consolidations, may include

- determining that the necessary journal entries are reflected in the consolidation, and
- evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

Consolidation Adjustments and Reclassifications (Ref: par. .40b)

.A156 The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements[83]that do not pass through the usual IT applications and may not be subject to the same controls to which other financial information is subject. The group auditor's evaluation of the appropriateness, completeness, and accuracy of the adjustments and reclassifications may include the following:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them
- Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included
- Determining whether significant adjustments have been correctly calculated, processed, and authorized by group management and, when applicable, by component management
- Determining whether significant adjustments are properly supported and sufficiently documented
- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits or losses, and intra-group account balances

Considerations When Component Auditors Are Involved (Ref: par. .44–.45)

.A157 When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's specialist is appropriate and communicate this to the group auditor. In such circumstances, when determining whether the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss the following with the component auditor:

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[83]Paragraph .21*b* of section 330.

- The nature, scope, and objectives of the auditor's specialist's work
- The component auditor's evaluation of the adequacy of the work of the auditor's specialist for the group auditor's purposes

.A158 The appropriate level of the group auditor's involvement may depend on the circumstances and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors, and the circumstances of the group audit engagement (for example, if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements). The group auditor's evaluation in accordance with paragraph .44 may be undertaken in a number of ways (for example, through communications with component auditors or review of selected component auditor audit documentation) (see paragraphs .A163–.A164).

Evaluating the Component Auditor's Communications and the Adequacy of Their Work

Communication About Matters Relevant to the Group Auditor's Conclusion With Regard to the Group Audit (Ref: par. .47)

.A159 Although the matters required to be communicated in accordance with paragraph .47 are relevant to the group auditor's conclusion with regard to the group audit, certain matters may be communicated during the course of the component auditor's procedures. In addition to the matters in paragraphs .34 and .68, such matters may include, for example

- information about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- information about instances of noncompliance with laws or regulations;
- newly arising significant risks of material misstatement, including risks of fraud;
- actual, suspected, or alleged fraud involving component management or employees that could have a material effect on the group financial statements;
- significant or unusual transactions;
- differences of opinion that arise within the component auditor or between the component auditor and the component engagement quality reviewer; or
- the nature and scope of, and conclusions resulting from, consultations undertaken by the component auditor and how such conclusions were implemented.

Communication of Misstatements of Component Financial Information (Ref: par. .47e)

.A160 Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph .47*g*. In addition, a higher-than-expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

Component Auditor's Overall Findings or Conclusions (Ref: par. .47k)

.A161 The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor's firm policies or procedures may address the form or specific wording of an overall conclusion from the component auditor on the audit work performed for purposes of the group audit.

Evaluating Whether Communications With the Component Auditor Are Adequate for the Group Auditor's Purposes (Ref: par. .48b)

.A162 If the group auditor determines that the component auditor's communications are not adequate for the group auditor's purposes, the group auditor may consider whether, for example

- further information can be obtained from the component auditor (for example, through further discussions or meetings).
- it is necessary to review additional component auditor audit documentation in accordance with paragraph .49.
- additional audit procedures may need to be performed in accordance with paragraph .50.
- there are any concerns about the component auditor's competence or capabilities.

Reviewing Additional Component Auditor Audit Documentation (Ref: par. .49)

.A163 Paragraph .A85 provides guidance for the group auditor in tailoring the nature, timing, and extent of the direction and supervision of the component auditor, and the review of their work, based on the facts and circumstances of the group audit and other matters (for example, the assessed risks of material misstatement of the group financial statements). The group auditor's consideration in accordance with paragraph .49*c* also may be affected by the following matters relevant to the group auditor's ongoing involvement in the work of the component auditor:

- Communications from the component auditor, including those in accordance with paragraph .47 of this section
- The review of component auditor audit documentation by the group auditor during the course of the group audit (for example, to fulfill the requirements of paragraphs .36, .44, and .45) or by the group engagement partner in accordance with paragraph .31 of section 220

.A164 Other factors that may affect the group auditor's determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include the following:

- The degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements
- The significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements
- The competence and capabilities of more experienced engagement team members from the component auditor responsible for reviewing the work of less experienced individuals
- Whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation

Considerations Regarding Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements

.A165 The requirements in paragraphs .51–.65 and the related application material in paragraphs .A166–.A187 apply only when the group engagement partner plans to obtain audit evidence through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios" and par. .10)

Understanding the Referred-to Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-to Auditors (Ref: par. .51)

.A166 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the referred-to auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit. Such requirements may be different or in addition to those applying to a referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the referred-to auditor's jurisdiction. When the referred-to auditor is not subject to the AICPA Code of Professional Conduct, compliance by the referred-to auditor with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* is sufficient to fulfill the referred-to auditor's ethical responsibilities in the group audit. [Revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

Competence and Capabilities of Referred-to Auditors (Ref: par. .52–.53)

.A167 Determining whether referred-to auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement.

.A168 In determining whether referred-to auditors have the appropriate competence and capabilities, the group engagement partner may consider matters such as the following:

- Previous experience with or knowledge of the referred-to auditor
- The referred-to auditor's specialized skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
- The referred-to auditor's understanding of the auditing and other standards applicable to the group audit that is sufficient to fulfill the referred-to auditor's responsibilities
- Whether a referred-to auditor operates in a regulatory environment that actively oversees auditors

.A169 The procedures to determine the referred-to auditor's competency and capability may include, for example, the following:

- Requesting the referred-to auditor to confirm the matter referred to in paragraph .52 in writing
- Obtaining published external inspection reports, peer review reports on the referred-to auditor's firm, and other relevant publicly available information relating to the professional reputation and standing of a referred-to auditor

.A170 If there has been a breach by a referred-to auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot make reference in the auditor's report on the group financial statements to the audit of the referred-to auditor. The group auditor also cannot use the work of that auditor in the capacity of a component auditor as described by this section.

.A171 Serious concerns are those concerns that in the group engagement partner's professional judgment cannot be overcome. The group engagement partner may be able to overcome less-than-serious concerns about the referred-to auditor's professional competency or the fact that the referred-to auditor does not operate in an environment that actively oversees auditors, by, for example, the group auditor directly performing further audit procedures on the financial information of the component.

*Determining Whether to Make Reference to the Audit of a Referred-to Auditor (Ref: **par. .55–.56**)*

.A172 The group engagement partner determines, individually for each component, whether to

- be involved in the work of the component auditor, insofar as that work relates to the expression of an audit opinion on the group financial statements, or

- make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

.A173 In group audits with two or more components, the decision to make reference is made individually for each potential referred-to auditor. The group auditor may make reference to any, all, or none of the potential referred-to auditors. For example, if one component is audited by an auditor from a network firm and another component is audited by a non-network firm, the group engagement partner may decide to be involved in the work of the auditor from the network firm and to make reference to the work of the auditor from the non-network firm.

.A174 The determination of whether to be involved in the work of the component auditor or make reference to the audit of a referred-to auditor may include factors related to the group being audited or factors related to the performance of audit procedures for the group audit. Factors that may affect the group engagement partner's determination of whether to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The group auditor's understanding of the group and its environment and the group's system of internal control
- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the potential referred-to auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group auditor to be involved in the audit of the component financial statements

.A175 If the group has a noncontrolling interest in an entity that is accounted for by the equity method and audited financial statements of the noncontrolled entity are available, in applying the requirements in paragraphs .51–.65, the group engagement partner may determine to make reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements. Alternatively, in applying the guidance in paragraphs .A188–.A190, the group auditor may determine the audited financial statements of the noncontrolled entity provide sufficient appropriate audit evidence regarding the noncontrolled entity's financial results. In this situation, the requirements in paragraph .66 are applicable and the group engagement partner does not make reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements.

Determining Whether the Audit of the Referred-to Auditor Was Conducted in Accordance With GAAS (Ref: par. .56a)

.A176 An auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB, is sufficient to make the determination required by paragraph .56*a*.[84] When the auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph .56*a*, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group auditor may provide the referred-to auditor with AU-C appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards," that identifies substantive requirements of GAAS that are not requirements in the ISAs. The referred-to auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the referred-to auditor required by paragraphs .62–.63 may address whether the audit met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the referred-to auditor, may decide to make reference to the audit of that referred-to auditor in the auditor's report on the group financial statements.

Determining Whether to Make Reference to the Audit of a Referred-to Auditor When the Financial Reporting Framework Is Not the Same (Ref: par. .57)

.A177 When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group auditor is required by this section to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the group auditor is involved in the audit of the component financial statements. In rare circumstances, however, the group engagement partner may conclude that the group auditor can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to be involved in the audit of the component financial statements.

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[84] Paragraphs .44–.46 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

.A178 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and International Financial Reporting Standards for Small and Medium-Sized Entities, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP.[85]

.A179 When the component prepares financial statements using a different financial reporting framework than that used by the group, additional considerations in determining whether it may be appropriate to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The effectiveness of controls related to financial reporting and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments
- The depth of the group auditor's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments
- The extent of the group auditor's knowledge of the financial reporting framework used to prepare the component financial statements
- The group auditor's ability to obtain information from group or component management that is relevant to the adjustments
- The need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments

Considerations for Governmental Entities

.A180 When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework

[85]Paragraph .06 of section 700.

established by GASB and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs .57 and .59*c* are not relevant.

Making Reference to the Audit of a Referred-to Auditor (Ref: par. .59–.61)

.A181 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor is not to be construed as a qualification of the opinion but, rather, is intended to communicate (*a*) that the group auditor was not involved in the work of the referred-to auditor, and (*b*) the source of the audit evidence with respect to those components for which reference to the audit of referred-to auditors is made.

.A182 The disclosure of the magnitude of the portion of the financial statements audited by a referred-to auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or percentages covered by the referred-to auditors may be stated in the aggregate.

.A183 Exhibit B contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements.

.A184 If there is a modified opinion, emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the referred-to auditor's report, but it does not affect the report on the group financial statements and the referred-to auditor's report is not presented, the group auditor need not make reference to those paragraphs or that section in the auditor's report on the group financial statements. If the referred-to auditor's report is presented, the group auditor may make reference to those paragraphs or that section and their disposition.

Communications With the Referred-to Auditor (Ref: par. .62–.65)

.A185 The communications between the group auditor and referred-to auditor regarding the matters in paragraphs .62–.63 support the group engagement partner taking overall responsibility for managing and achieving quality on the group audit engagement without the group auditor being involved in the work of the referred-to auditor. Therefore, for this purpose, when a referred-to auditor's audit is not yet completed, the referred-to auditor may request the group auditor to communicate, or the group auditor may otherwise communicate, additional information that may be relevant to the referred-to auditor's work (for example, identified significant risks of the group financial statements).

.A186 The form of the communications between the group auditor and referred-to auditors may vary and may not necessarily be in writing. However, verbal communications between the group auditor and referred-to auditors may be supplemented by written communication, such as the group auditor obtaining written representations from the referred-to auditor confirming that the referred-to auditor has complied with the ethical requirements that are relevant to the group audit engagement, including independence, or communicating matters related to the referred-to auditor's competence and capabilities.

.A187 The referred-to auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph .62*b* to communicate to any other referred-to auditors those related party relationships or transactions if they are relevant to the work of the other referred-to auditors.

Considerations Regarding Using Audited Financial Statements of a Noncontrolled Entity That Is Accounted for by the Equity Method as Audit Evidence (Ref: par. .66)

.A188 It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements, whether audited financial statements of the noncontrolled entity, including the accompanying audit report, are satisfactory to be used as audit evidence regarding the noncontrolled entity's financial results. Obtaining and reading the audited financial statements may be sufficient for the purpose of obtaining sufficient appropriate audit evidence regarding the noncontrolled entity's financial results. In making this determination, the group auditor may consider the following:

- The professional competence and independence of the noncontrolled entity's auditor (investee's auditor)
- The adequacy of the standards under which the investee's auditor's report was issued
- Whether there is a difference between the financial statement periods of the group and the noncontrolled entity, and if so, whether such a difference has or could have a material effect on the group financial statements (for example, due to a change in the fiscal year-end lag period between the financial statement period-ends of the group and the noncontrolled entity, the prior period comparative statements are no longer consistent, or a significant transaction occurring during the time period between the financial statement period-ends of the group and the noncontrolled entity has a material effect on the group financial statements).

.A189 After obtaining and reading the audited financial statements of the noncontrolled entity, the group auditor may conclude that additional audit procedures (see paragraph .A190) are necessary to obtain sufficient appropriate audit evidence regarding the noncontrolled entity's financial results, for example, due to the significance of the investment to the group financial statements or when

- there are concerns about the professional competence or independence of the investee's auditor.
- there are significant differences in fiscal year-ends between the group financial statements and the noncontrolled entity financial statements (for example, there is

a fiscal year-end lag period, a change in the fiscal year-end lag period, or a significant transaction occurs during the time period between the financial statement period-ends of the group and the noncontrolled entity).

- there are significant differences in the auditor's report dates between the group auditor's report and the investee's auditor's report (for example, there are subsequent events between the investee's auditor's report date and the group auditor's report date).
- there are significant differences in accounting principles between the group financial statements and the noncontrolled entity financial statements.
- there are significant differences between the carrying amount of the noncontrolled entity on the group financial statements and the underlying equity in net assets of the noncontrolled entity on the noncontrolled entity financial statements.
- there are changes in ownership of the noncontrolled entity.
- there are changes in conditions affecting the use of the equity method.
- there are material transactions between the group and the noncontrolled entity.

.A190 To obtain sufficient appropriate audit evidence regarding the noncontrolled entity's financial results through using the audited financial statements, the group auditor may perform additional procedures such as the following:

- Evaluating information regarding the professional reputation and standing of the investee's auditor
- Interacting with the investee's auditor
- Discussing the audit procedures performed by the investee's auditor and the results thereof
- Reviewing the audit plan and audit documentation of the investee's auditor
- Reviewing information in group management's files that relates to the noncontrolled entity such as minutes, budgets, cash flow information, and information regarding the time period between the date of the noncontrolled entity financial statements and the date of the group financial statement, if different
- Making inquiries of group management about the noncontrolled entity's financial results
- Reading available interim financial statements of the noncontrolled entity and making inquiries of management of the noncontrolled entity regarding subsequent events or transactions of the noncontrolled entity
- Obtaining audit evidence regarding significant differences between the carrying amount of the noncontrolled entity on the group financial statements and the underlying equity in net assets of the noncontrolled entity on the noncontrolled entity financial statements, if applicable

.A191 If in applying the guidance in paragraphs .A188–.A190 the group auditor determines that the audited financial statements of the noncontrolled entity, including the accompanying audit report, are not satisfactory or do not provide sufficient appropriate audit evidence regarding the noncontrolled entity's financial results, the requirements in this section regarding obtaining sufficient appropriate audit evidence regarding the noncontrolled entity's (that is, a component's) financial results, without making reference to the audit of the noncontrolled entity's auditor in the auditor's report on the group financial statements, are applicable. Furthermore, if the group auditor involves the noncontrolled entity's auditor in the group audit (that is, in the capacity of a component auditor), the requirements related to being involved in the work of the noncontrolled entity's auditor are applicable. In this situation, the noncontrolled entity's auditor is considered a component auditor and is a part of the engagement team for a group audit.

Subsequent Events (Ref: par. .67–.68)

.A192 When component auditors are involved, the group auditor may

- request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements.
- perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor's report on the group financial statements, if applicable.

.A193 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, procedures designed to identify subsequent events between the date of the referred-to auditor's report and the date of the auditor's report on the group financial statements may include the following:

- Obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified
- Requesting the referred-to auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements
- Requesting specific written representations from component management regarding subsequent events
- Reading available interim financial information of the component and making inquiries of group management
- Reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date
- Reading the subsequent year's capital and operating budgets

- Inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events

.A194 In applying section 330, if the group auditor is unable to obtain sufficient appropriate audit evidence, including with regard to subsequent events that require adjustment of, or disclosure in, the group financial statements, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements.[86]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. .69)

.A195 The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing, or extent of other planned audit procedures because information may come to the group auditor's attention that differs significantly from the information on which the risk assessment was based, for example

- the misstatements identified at a component may need to be considered in relation to other components, or
- the group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (for example, war, civil unrest, or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of transactions, account balances, or disclosures and related relevant assertions.

.A196 The evaluation required by paragraph .69 assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in section 330[87] for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

.A197 The group auditor may consider the engagement team's maintenance of professional skepticism when evaluating the sufficiency and appropriateness of audit evidence obtained. For example, the group auditor may consider whether matters such as those described in paragraph .A17 have inappropriately led the engagement team to

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[86] Paragraphs .08–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, address qualified, adverse, and disclaimer of opinions.

[87] Paragraph .18 of section 330.

- obtain audit evidence that is easier to access without giving appropriate consideration to its relevance and reliability,
- obtain less persuasive evidence than is necessary in the circumstances, or
- design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

.A198 Section 220[88]requires the engagement partner to determine, on or before the date of the auditor's report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. Information that may be relevant to the group auditor's evaluation of the audit evidence obtained from the work performed by component auditors or through making reference to the audit of referred-to auditors in the auditor's report on the group financial statements depends on the facts and circumstances of the group audit and may include the following:

- Communications from the component auditors required by paragraph .47, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit
- Other communications from the component auditors throughout the group audit, including those required by paragraph .34
- The group auditor's direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph .49
- The referred-to auditor's report on the component's financial statements, including, as applicable, if the opinion of a referred-to auditor is modified or if that report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section
- Communications from the referred-to auditors required by this section

.A199 In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

Evaluating the Effect on the Group Audit Opinion (Ref: par. .70)

.A200 The group engagement partner's evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (for example, regarding transactions subject to common accounting policies or common controls) that may affect other components.

[88]Paragraph .32 of section 220.

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. .71)

.A201 When component auditors are involved in the group audit, no reference is made to the component auditor in the auditor's report on the group financial statements because to do so may cause a reader to misinterpret the degree of responsibility of the group auditor.

.A202 When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the "Basis for Qualified Opinion" or "Basis for Disclaimer of Opinion" section in the auditor's report on the group financial statements describes the reasons for that inability. In some circumstances, the group auditor may decide a reference to a component auditor or referred-to auditor is necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management (Ref: par. .72–.74)

.A203 The group audit may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph .A7, the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the planned scope and timing may help in coordinating the work performed at components, including when component auditors are involved or reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, and in identifying component management (see paragraph .A27).

.A204 Section 240[89]contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.

.A205 Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation
- Plans for abandonment of material operating assets
- Subsequent events

[89]Paragraphs .40–.42 of section 240.

- Significant legal agreements

.A206 Group management may inform the group auditor about noncompliance or suspected noncompliance with laws or regulations in entities or business units within the group. Paragraph .A97 provides guidance for the group engagement partner in these circumstances.

Communication With Those Charged With Governance of the Group (Ref: par. .75)

.A207 The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors or referred-to auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph .75*a* may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph .75*b* may be communicated at the end of the audit, and the matters referred to in paragraph .75*c–d* may be communicated when they occur.

.A208 Section 260[90]requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor's determination of the components at which audit work will be performed, including whether certain of the group's entities or business units will be considered together as a component, the planned involvement of component auditors, and the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph .32) and areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

Communication of Identified Deficiencies in Internal Control (Ref: par. .76)

.A209 The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies or material weaknesses.[91]The group auditor may request input from the component auditor about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency or material weakness in internal control.

Documentation (Ref: par. .77)

.A210 Other AU-C sections contain specific documentation requirements that are intended to clarify the application of section 230 in the particular circumstances of those other

[90]Paragraph .11 of section 260.

[91]Paragraph .09 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

AU-C sections. The exhibit to section 230 lists other AU-C sections that contain specific documentation requirements and guidance.

.A211 The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph .69 about whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph .A198.

.A212 The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with QM section 10.[92]The group auditor may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

Basis for the Group Auditor's Determination of Components (Ref: par. .77b)

.A213 The basis for the group auditor's determination of components may be documented in various ways, including, for example, documentation related to the fulfillment of the requirements in paragraphs .24, .35, and .75*a* of this section.

Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors (Ref: par: .77d)

.A214 QM section 10[93]provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members. Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph .26 may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures.

Documentation of the Direction and Supervision of Component Auditors and the Review of Their Work (Ref: par. .77f)

.A215 As described in paragraph .A85, the approach to direction, supervision, and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

.A216 Section 300[94]requires the auditor to develop an audit plan that includes a description of the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved, the

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[92]Paragraphs .32*f* and .A87–.A89 of QM section 10.

[93]Paragraph .A100 of QM section 10.

[94]Paragraph .09 of section 300.

extent of such descriptions will often vary by component, recognizing that the planned nature, timing, and extent of direction and supervision of component auditors, and review of their work, may be influenced by the matters described in paragraph .A59.

.A217 The group auditor's documentation of the direction and supervision of component auditors and the review of their work may include, for example, the following:

- Required communications with component auditors, including any instructions issued and other confirmations required by this section.
- The rationale for the selection of visits to component auditor sites, attendees at meetings, and the nature of the matters discussed.
- Matters discussed in meetings with component auditors or component management.
- The rationale for the group auditor's determination of component auditor audit documentation selected for review.
- Changes in the planned nature and extent of involvement with component auditors and the reasons why. This may include circumstances in which the group auditor modified the nature, timing, or extent of the direction and supervision of the component auditors, and the review of their work, in areas of the audit that are more complex or subjective than initially anticipated.

.A218 Paragraph .49 requires the group auditor to determine whether, and the extent to which it is necessary, to review additional component auditor audit documentation. Paragraphs .A163–.A164 provide guidance for the group auditor in making this determination.

.A219 Component auditor audit documentation ordinarily need not be replicated in the group auditor's audit file. However, the group auditor may decide to summarize, replicate, or retain copies of certain component auditor documentation in the group auditor's audit file to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this section. Examples of such component auditor documentation may include

- summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit,
- matters that may need to be communicated to those charged with governance of the group, or
- matters that may be determined to be key audit matters to be communicated in the auditor's report on the group financial statements, when engaged to do so.

.A220 When required by law or regulation, certain component auditor documentation may need to be included in the group auditor's audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.

.A221 Policies or procedures established by the firm in accordance with the firm's system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing information about the reviewers and the dates and extent of their review.

Additional Considerations When Access to Component Auditor Audit Documentation Is Restricted (Ref: par. .77)

.A222 Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest, or outbreaks of disease restrict access to relevant component auditor audit documentation.

.A223 The group auditor may be able to overcome such restrictions by, for example

- visiting the location of the component auditor, or meeting with the component auditor in a location different from where the component auditor is located, to review the component auditor's audit documentation;
- reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
- requesting the component auditor to prepare and provide a memorandum that addresses the relevant information and holding discussions with the component auditor, if necessary, to discuss the contents of the memorandum; or
- discussing with the component auditor the procedures performed, the evidence obtained, and the conclusions reached by the component auditor

It is a matter of professional judgment whether one or more of the preceding actions may be sufficient to overcome the restrictions, depending on the facts and circumstances of the group audit.

.A224 When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of GAAS, including those relating to the documentation of the nature, timing, and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs .A163–.A164 may be helpful in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs .A219–.A220 provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.

.A225 If the group auditor is unable to overcome restrictions on access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph .A52.

Exhibit A — Relevancy of Requirements in Various Group Audit Scenarios (Ref: par. .10, .12, .58*a*, .A7, and .A165)

.A226 The requirements of this section are intended to be applied in the context of the nature and circumstances of each group audit. The following are various scenarios related to how a group audit may be carried out. Depending on the involvement of component auditors or whether reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements, certain requirements in this section may not be relevant due to their conditionality. The following table provides examples of the requirements in this section that are relevant for various group audit scenarios.

Regardless of the scenario, as required by paragraph .21 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the group auditor is required to have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objectives and apply its requirements properly. Paragraphs .01–.17 of this section, which include the introduction, objectives, and definitions, are applicable for all the following scenarios.

Group Audit Scenario	Relevant Requirements
Scenario 1 – Group Auditor *The group audit is carried out entirely by the group auditor, including when only one component has been identified.*	• Paragraphs .18–.24 • Paragraph .32 • Paragraph .35 • Paragraph .37 • Paragraphs .39–.42 • Paragraphs .66–.67 • Paragraphs .69–.70 • Paragraphs .72–.73 • Paragraphs .75–.77
Scenario 2 – Group Auditor and Component Auditors *Component auditors are involved in the group audit.*	• Paragraphs .18–.50 • Paragraphs .66–.77
Scenario 3 – Group Auditor and Referred-to Auditors *The group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements (component auditors are not involved).*	• Paragraphs .18–.24 • Paragraph .32 • Paragraph .35 • Paragraph. 37 • Paragraphs .39–.42 • Paragraphs .51–.67 • Paragraphs .69–.70 • Paragraphs .72–.77
Scenario 4 – Group Auditor, Component Auditors, and Referred-to Auditor *Component auditors are involved in the group audit, and the group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.*	• Paragraphs .18–.77

Exhibit B — Illustrative Auditor's Reports on Group Financial Statements (Ref: par. .A52)

.A227

Illustration 1: Independent Auditor's Report With a Qualified Opinion When the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Auditor's Opinion

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by FASB.
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in section 210, *Terms of Engagement*.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method because the group auditor was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a referred-to auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events considered in the aggregate that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters in accordance with section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Report on the Audit of the Consolidated Financial Statements[1]

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Company or ABC Company), which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at $__ and $__ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of $__ and $__, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

[1]The subtitle, "Report on the Audit of the Consolidated Financial Statements," is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

***Other Information* [*or another title, if appropriate, such as* "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[2]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports, *for when there is a qualified opinion due to limitation of scope*.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of auditor's firm]*

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Generally Accepted Auditing Standards

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by FASB.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

[1]The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Company or ABC Company), which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

***Other Information* [*or another title, if appropriate, such as* "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[2]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a referred-to auditor in accordance with GAAS.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Company or ABC Company), which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

[1] The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose

of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information **[*or another title, if appropriate, such as* "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

2 In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4: A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with auditing standards other than GAAS or standards promulgated by the PCAOB. The group engagement partner has determined that the referred-to auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the referred-to auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Company or ABC Company), which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, based on our audits and the report of and additional audit procedures performed by the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, whose statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [*describe the set of auditing standards*], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of

[1]The subtitle, "Report on the Consolidated Financial Statements," is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.
In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

***Other Information* [*or another title, if appropriate, such as* "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[2] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Appendix A — Understanding the Group's System of Internal Control (Ref: par. .A98)

.A228

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment and expands on how section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,[1] is to be applied in relation to an audit of group financial statements. The examples may not be relevant to every group audit engagement, and the list of examples is not necessarily complete.

Control Environment

2. The group auditor's understanding of the control environment may include matters such as the following:

- The structure of the governance and management functions across the group, and group management's oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group
- How oversight over the group's system of internal control by those charged with governance is structured and organized
- How ethical and behavioral standards are communicated and reinforced in practice across the group (for example, group-wide programs, such as codes of conduct and fraud prevention programs)
- The consistency of policies and procedures across the group, including a group financial reporting procedures manual

The Group's Risk Assessment Process

3. The group auditor's understanding of the group's risk assessment process may include matters such as group management's risk assessment process, that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group's risk assessment process is and the involvement of entities and business units in this process.

The Group's Process to Monitor the System of Internal Control

4. The group auditor's understanding of the group's process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group, including its nature, responsibilities, and activities in respect of

[1] Appendix C of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

monitoring of controls at entities or business units in the group. section 610, *Using the Work of Internal Auditors*,[2]requires the auditor to evaluate the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including quality control.

The Information System and Communication

5. The group auditor's understanding of the group's information system and communication may include matters such as the following:

- The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes, and IT infrastructure
- Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets and to take appropriate action
- Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at the group level
- A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group

Consolidation Process

6. The group auditor's understanding of the consolidation process may include matters such as the following:

Matters Relating to the Applicable Financial Reporting Framework:

- The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework
- The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework
- The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework
- The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework

  The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework

[2]Paragraph .13 of section 610, *Using the Work of Internal Auditors.*

- The procedures for dealing with entities or business units in the group with financial year-ends different from the group's year-end

Matters Relating to the Consolidation Process:

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified and adjusted when required in terms of the applicable financial reporting framework. *Uniform accounting policies* are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
- Group management's process for ensuring complete, accurate, and timely financial reporting by the entities or business units in the group for the consolidation.
- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters Relating to Consolidation Adjustments and Reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization, and processing of related journal entries, and the experience of personnel responsible for the consolidation
- The consolidation adjustments required by the applicable financial reporting framework
- The business rationale for the events and transactions that gave rise to the consolidation adjustments
- Frequency, nature, and size of transactions between entities or business units in the group
- The procedures for monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework

- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (for example, an obligation of the minority interest to make good such losses)

Control Activities

7. The group auditor's understanding of the control activities component may include matters such as the following:

- The commonality of information-processing controls and general IT controls for all or part of the group
- The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level
- The extent to which commonly designed controls have been implemented consistently for all or part of the group

Appendix B — Examples of Events or Conditions That May Give Rise to Risks of Material Misstatement of the Group Financial Statements (Ref: par. .A124)

.A229 The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to or affected by other inherent risk factors to varying degrees. Also see appendix B, "Understanding Inherent Risk Factors," of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Inherent Risk Factor	Examples of Events or Conditions That May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:
Complexity	• The existence of complex transactions that are accounted for in more than one entity or business unit in the group • The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements • Accounting measurements or disclosures that involve complex processes used by entities or business units in the group, such as accounting for complex financial instruments • Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation
Subjectivity	• Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any variable interest entities or non-trading entities exist and require incorporation • Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group
Change	• Frequent acquisitions, disposals, or reorganizations
Uncertainty	• Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, restrictions on currency and dividend movements, and fluctuations in exchange rates
Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	• Unusual related party relationships and transactions • Entities or business units in the group with different financial year-ends, which may be used to manipulate the timing of transactions • Prior occurrences of unauthorized or incomplete consolidation adjustments • Aggressive tax planning within the group or large cash transactions with entities in tax havens • Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation • Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk

Indicators that the control environment, the group's risk assessment process, or the group's process to monitor the group's system of internal control are not appropriate to the group's circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group's system of internal control, include the following:

- Poor corporate governance structures, including decision-making processes that are not transparent
- Nonexistent or ineffective controls over the group's financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group

Appendix C — Amendments to Various Statements on Auditing Standards (SASs), as Amended, and to Various Sections in SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended

.A230

(***Boldface italics*** denotes new language. Deleted text is shown in ~~strikethrough~~.)

Amendment to SAS No. 117, *Compliance Audits*, as Amended (AU-C sec. 935)

1. The amendment to AU-C section 935 is effective for compliance audits for fiscal periods ending on or after December 15, 2026.

AU-C Section 935, *Compliance Audits*

[No amendment to paragraphs .01–.14.]

Using the Work of Another Auditor

.15 When the auditor expects to use the work of another auditor, the auditor should (Ref: par. .A12–.A13)

a. ***confirm whether the other auditor understands and will comply with the relevant ethical requirements, including those related to independence, that apply to the engagement.***

b. ***determine that the other auditor has appropriate professional competence and capabilities.***

c. ***determine whether to make reference to the compliance audit of the other auditor in the auditor's report.***

d. ***when the auditor involves another auditor to perform audit work to fulfill the requirements of this section***

i. communicate clearly with the other auditor about the other auditor's respective responsibilities and the auditor's expectations, including the scope and timing of the other auditor's work and the matters expected to be communicated by the other auditor that are relevant to the auditor's conclusions with regard to the compliance audit;

ii. determine that the other auditor has sufficient time to perform assigned audit procedures; and

iii. be sufficiently and appropriately involved in the work of the other auditor.

e. ***evaluate whether the other auditor's work is adequate for the auditor's purposes.***

[Subsequent paragraphs renumbered. No amendment to renumbered paragraphs .16–.49. No amendment to paragraphs .A1–.A11.]

Using the Work of Another Auditor (Ref: par. .15)

.A12 Section 220,* Quality Management in an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, fn 15 *requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. Accordingly, the auditor may involve another auditor to perform audit work to fulfill the requirements of this section. The engagement partner may also determine to use work completed by another auditor or to make reference to the compliance audit of another auditor in the auditor's report.

fn 15 Paragraph .25 of section 220, *Quality Management in an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

.A13 Regardless of whether the auditor uses the work of another auditor (including making reference to the compliance audit of another auditor in the auditor's report) as a basis for forming an opinion at the level specified by the governmental audit requirement, the engagement partner remains ultimately responsible and therefore accountable for compliance with the requirements of this section. SAS No. 149,* Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, adapted as necessary in the circumstances, may be useful in fulfilling the requirements in paragraph .15 of this section when using the work of another auditor.

[Subsequent paragraphs and footnotes renumbered. No amendment to renumbered paragraphs .A14–.A46.]

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits*[fn 1]*

.A~~45~~*47* The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (*a*) they are not relevant to a compliance audit environment, (*b*) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (*c*) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor's opinion on compliance.

[fn 1] [Footnote omitted for purposes of this SAS.]

AU-C Section	Paragraphs Not Applicable to Compliance Audits
...	
600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*	~~Paragraphs .26, .39, .41c, .41d, .55, and .56c~~ ***All***
...	

[No further amendment to AU-C section 935.]

Amendments to Various Sections in SAS No. 122, as Amended (AU-C secs. 230, 260, 300, 320, 402, 450, 501, 510, 550, 805, 920, and 930)

AU-C Section 230, Audit Documentation

2. The amendment to AU-C section 230 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A29.]

Exhibit — Audit Documentation Requirements in Other AU-C Sections

.A30 The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

...

q. Paragraphs **77**~~.49 and .64~~ of ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*

...

[No further amendment to AU-C section 230.]

AU-C Section 260, The Auditor's Communication With Those Charged With Governance

3. The amendment to AU-C section 260 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A8.]

Those Charged With Governance

...

.A9 ~~Section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, includes specific matters to be communicated by ***the*** group auditors with those charged with governance ***of the group***. *fn 3* ***The matters communicated may include***

those brought to the attention of the group auditor by component auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Component auditors also may communicate matters to those charged with governance of the component. **fn 4** When the entity being audited is a component of a group, the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

fn 3 Paragraphs **75** *~~.46–.49~~ of ~~section 600~~* **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors****).*

fn 4 Paragraph 47 *i* of SAS No. 149.

[Subsequent footnotes renumbered. No amendment to paragraphs .A10–.A57.]

Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

.A58 Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

…

i. paragraphs ~~.46–.49~~ ***75*** of ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*

…

[No further amendment to AU-C section 260.]

AU-C Section 300, Planning an Audit

4. The amendment to AU-C section 300 is effective for audits of financial statements for periods ending on or after December 15, 2026.

Scope of This Section

.01 This section addresses the auditor's responsibility to plan an audit of financial statements. This section is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified in this section. Matters related to planning audits of group financial statements are addressed in ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*. (Ref: par. .A1–.A4)

[No amendment to paragraphs .02–.A9.]

Planning Activities

The Overall Audit Strategy (Ref: par. .07–.08)

.A10 The process of establishing the overall audit strategy, subject to the completion of the auditor's risk assessment procedures, may include such matters as the following:

- The nature of resources (human, technological, or intellectual) to be deployed for specific audit areas, for example, the deployment of experienced team members for high risk areas or the assignment of specialists to address complex matters
- The amount of resources to be allocated to specific audit areas, for example, the number of team members assigned to attend the physical inventory count at multiple locations, the ***nature and*** extent of ***direction and supervision of component auditors and the*** review of ***their*** ~~component auditors'~~ work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are directed, supervised, or used, for example, when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on-site or off-site)
- ***The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor***

[No amendment to paragraphs .A11–.A29.]

Appendix — Considerations in *Managing Quality at the Engagement Level* (Ref: par. .07–.08, .A9–.A12)

.A30 This appendix provides examples of matters the auditor may consider in managing quality at the engagement level. Many of these matters will influence the auditor's overall audit strategy and detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

Characteristics of the Engagement

…

- The expected audit ~~coverage~~ ***scope***, including the ~~number and locations of~~ components ***at which audit work is expected to be performed for purposes of a group audit, the extent to which component auditors will be involved, and the components that are audited by referred-to auditors for which the group auditor plans to make reference to the audit of the referred-to auditor in the auditor's report on the group financial statements*** ~~to be included~~
- The nature of the control relationships between a parent and its ***entities or business units*** ~~components~~ that determine how the group is to be consolidated

- ~~The extent to which components are audited by other auditors~~
- The nature of the ***entities or*** business ***units*** ~~divisions~~ to be audited, including the need for specialized ***skills or*** knowledge
- The reporting currency to be used, including any need for currency translation for the audited financial information
- The ***requirement*** ~~need~~ for ***an audit of financial statements for legal,*** ~~statutory or~~ regulatory***, or other reasons*** ~~audit requirements~~ (for example, ***Title 2 U.S.* Code of Federal Regulations *[CFR] Part 200,* Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards *[Uniform Guidance]***~~the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*~~)

…

Reporting Objectives, Timing of the Audit, and Nature of Communications

…

- Communication with ***component*** auditors ~~of components~~ regarding the expected types and timing of ~~reports to be issued and other~~ communications in connection with the audit ***work performed for purposes of the group audit*** ~~of components~~
- ***Communication with referred-to auditors regarding the expected types and timing of communications in connection with making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements***
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of ***audit*** work performed

…

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
  - The determination of ***component performance*** materiality ~~for components~~ and ***the threshold above which misstatements identified in the component financial information are to be communicated to the group auditor and*** communication thereof to component auditors in accordance with ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial*

Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors****)*

— The ***initial expectations about the*** ~~preliminary identification of significant components and material~~ classes of transactions, account balances, and disclosures ***that may be significant***

...

[No further amendment to AU-C section 300.]

AU-C Section 320, Materiality in Planning and Performing an Audit

5. The amendment to AU-C section 320 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.08.]

Definitions

.09 For purposes of generally accepted auditing standards (GAAS), the following ~~term has~~ ***terms have*** the ~~meaning~~ ***meanings*** attributed as follows:

*Aggregation risk****. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.***

Performance materiality. The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce ***aggregation risk*** to an appropriately low level ~~the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole~~. If applicable, *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. (Ref: par. .A3)

[No amendment to paragraphs .10–.A14.]

Determining Materiality and Performance Materiality When Planning the Audit

...

Performance Materiality (Ref: par. .11)

.A15 Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. *Performance materiality* (which, as defined, is one or more amounts) is set ***at less than materiality for the financial statements as a whole*** to reduce ***aggregation risk*** to an appropriately low level ~~the probability that the aggregate of~~

~~uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole~~. Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance, or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance, or disclosure exceeds the materiality level for that particular class of transactions, account balance, or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period.

[No further amendment to AU-C section 320.]

AU-C Section 402, Audit Considerations Relating to an Entity Using a Service Organization

6. The amendment to AU-C section 402 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A18.]

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

…

Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity (Ref: par. .12)

…

.A19 Another auditor may be used to perform procedures that will provide the necessary information about the controls at the service organization related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in section ***220,* Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards** ~~600~~, ~~*Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*~~, useful as it relates to ***determining the competence and capabilities of the other*** ~~understanding another~~ auditor (including that auditor's independence~~ and professional competence~~); ***the direction and supervision*** ~~involvement in the work~~ of ***the other*** ~~another~~ auditor***;*** ~~in planning~~ the nature, ***timing, and*** extent~~, and timing~~ of ~~such~~ ***the*** work ***assigned to the other auditor***; and ~~in~~ evaluating the sufficiency and appropriateness of the audit evidence obtained. *fn 9*

fn 9 **See section 220, *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards.*** ~~*Paragraphs .02 and .22 of*~~

~~*section 600,* Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors).~~

[No further amendment to AU-C section 402.]

AU-C Section 450, Evaluation of Misstatements Identified During the Audit

7. The amendment to AU-C section 450 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A24.]

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

…

.A25 The auditor is required by ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, to evaluate the effect on the group audit opinion of any uncorrected misstatement identified by the group ***auditor*** ~~engagement team~~ or communicated by the component auditors. *fn 18*

fn 18 *Paragraph* **70**~~*.44*~~ *of* ~~*section 600,*~~**SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No further amendment to AU-C section 450.]

AU-C Section 501, Audit Evidence — Specific Considerations for Selected Items

8. The amendment to AU-C section 501 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A4.]

Investments in Securities and Derivative Instruments (Ref: par. .05–.06)

…

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .05–.06)

.A5 ~~Section 600~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, addresses auditing investments accounted for using the equity method of accounting.

[No amendment to paragraphs .A6–.A22.]

Inventory

***Attendance at Physical Inventory Counting (Ref: par. .12* a)**

...

.A23 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .12–.16) include, for example, the following:

...

- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. ~~Section 600 addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.~~

...

[No further amendment to AU-C section 501.]

AU-C Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements

9. The amendment to AU-C section 510 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A7.]

Audit Procedures (Ref: par. .07)

...

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor's audit documentation for information relevant to planning and performing the audit. The auditor's determination whether to use information resulting from such review as part of the auditor's risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor's assessment of the professional competence and independence of the predecessor auditor. Although the predecessor auditor is not a component auditor ***or referred-to auditor***, as defined in ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, the auditor may ***perform procedures*** ~~make inquiries~~ similar to those ***included*** ~~listed~~ in ~~section 600~~ ***SAS No. 149*** concerning the ~~professional~~ competence ***and capabilities*** and independence of the predecessor auditor. *fn1* (Ref: par. .07 and .08*c*)

fn 1 *Paragraph***s** ~~*.22*~~**27, 28, 51, and 52** *of* ~~*section 600,*~~ **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No further amendment to AU-C section 510.]

AU-C Section 550, Related Parties

10. The amendment to AU-C section 550 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A10.]

Risk Assessment Procedures and Related Activities

Understanding the Entity's Related Party Relationships and Transactions

…

The Identity of the Entity's Related Parties (Ref: par. .14a)

…

.A11 In the context of a group audit, ~~section 600~~***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, requires the group ***auditor*** ~~engagement team~~ to ***request component auditors and referred-to auditors to communicate related party relationships not previously identified by group management or the group auditor on a timely basis*** ~~provide each component auditor with information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties~~. *fn 24* ~~When the entity is a component within a group, this~~ ***Such*** information provides a useful basis for the ***group*** auditor's inquiries of management regarding the identity of ~~the entity's~~ related parties.

fn 24 *Paragraph***s 34*b*~~.41c~~ and 62*c*(ii)** *of* ~~*section 600*~~ **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No amendment to paragraphs .A12–.A30.]

Sharing Related Party Information With the Engagement Team (Ref: par. .19 and .25 **a*)***

…

.A31 ~~Section 600~~ ***SAS No. 149*** addresses the communications that apply to group audits, particularly those that involve component auditors ***or when reference is made to referred-to auditors.*** **fn 30**

fn 30 Paragraphs 33b, 34b, 62b, and 62c(ii) of SAS No. 149.

[Subsequent footnotes renumbered. No amendment to paragraphs .A32–.A41.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. .22)

…

Identified Related Party Transactions Required to Be Disclosed or Determined to Be a Significant Risk

*Evaluating the Business Purpose (Ref: par. .26*a*(i))*

.A42 In evaluating the business purpose of a related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk, the auditor may consider the following:

- Whether the transaction
  - — is overly complex (for example, it may involve multiple related parties within a ~~consolidated~~ group)

…

[No further amendment to AU-C section 550.]

AU-C Section 805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement

11. The amendment to AU-C section 805 is effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2026.

Scope of This Section

[No amendment to paragraph .01.]

.02 This section does not apply to ***circumstances in which*** ~~the report~~ ***audit procedures are performed by*** ~~of~~ a component auditor ~~issued as a result of work performed~~ on the financial information of a component ~~at the request of a group engagement team~~ for purposes of an audit of group financial statements (see ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements [Including the Work of Component Auditors* **and Audits of Referred-to Auditors***]*).

[No further amendment to AU-C section 805.]

AU-C Section 920, Letters for Underwriters and Certain Other Requesting Parties

12. The amendment to AU-C section 920 is effective for comfort letters issued on or after December 15, 2026.

[No amendment to paragraphs .01–.20.]

Agreeing Upon the Scope of Services

...

.21 Situations may exist in which one or more component auditor's ***or referred-to auditor's*** report is included in the securities offering. When comfort letters are issued to requesting parties by those component auditors ***or referred-to auditors***, the auditor of the group financial statements should read those comfort letters. The auditor of the group financial statements should state in the comfort letter that the procedures relating to those components consisted solely of reading the component auditors' ***or referred-to auditors'*** comfort letters.

[No amendment to paragraphs .22–.A18.]

Agreeing Upon the Scope of Services (Ref: par. .15–.23)

...

.A19 Comfort letters are requested occasionally from more than one auditor, for example, in connection with securities offerings to be used in the subsequent sale of shares issued in recently effected mergers and from predecessor auditors. In such circumstances, it is the entity's responsibility, at the earliest practicable date, to inform any other auditors who may be involved about any letter that may be requested of them and arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter and for the performance of their procedures. The entity or requesting party is also responsible for arranging for a copy of the comfort letters of component auditors ***or referred-to auditors*** in draft and final form to be provided to the auditor of the group financial statements.

[No amendment to paragraphs .A20–.A26.]

Format and Contents of Comfort Letters

...

Addressee (Ref: par. .26)

.A27 An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters." Copies of a comfort letter addressed in accordance with the requirements in paragraph .26 may be provided to the auditor of the group financial statements when a comfort letter related to a component included in group financial statements is issued by a component auditor ***or referred-to auditor***.

[No amendment to paragraphs .A28–.A69.]

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

...

Subsequent Changes (Ref: par. .58–.64)

…

.A70 When more than one auditor is involved, the auditor of the group financial statements may comment that there were no decreases in the consolidated financial statement items, when appropriate, despite the possibility that decreases have been mentioned in a comfort letter issued by a component auditor ***or referred-to auditor***. Exhibit B, example J, "Alternate Wording When Component Auditors Are Involved ***or When Making Reference to the Audit of a Referred-to Auditor***," contains an illustration of wording when more than one auditor is involved.

[No amendment to paragraphs .A71–.A92.]

Exhibit B — Examples of Comfort Letters

.A93

…

Example J — Alternate Wording When Component Auditors Are Involved ***or When Making Reference to the Audit of a Referred-to Auditor***

…

…

Example J — Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor*

.A93-14 Example J applies when one or more component auditors are involved in the audit of group financial statements ***or when reference is made to the audit of a referred-to auditor in the auditor's report on group financial statements***, and the group engagement team has obtained a copy of the comfort letter of the component auditors ***or referred-to auditors*** (see paragraph .21). Example J consists of an addition to paragraph 4, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A-1 and corresponding changes to paragraphs 3, 4, and 5 of example A-2, respectively.

…

[No further amendment to AU-C section 920.]

AU-C Section 930, Interim Financial Information

13. The amendment to AU-C section 930 is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.13.]

Procedures for a Review of Interim Financial Information

…

Analytical Procedures, Inquiries, and Other Review Procedures

...

Inquiries and Other Review Procedures

.14 The auditor should make the following inquiries and perform the following other review procedures when conducting a review of interim financial information ***(Ref: par. .A17)***:

a. Read the available minutes of meetings of stockholders, directors, and appropriate committees and inquire about matters dealt with at meetings for which minutes are not available to identify matters that may affect the interim financial information. (Ref: par. .A16)

~~*b.* Obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued. (Ref: par. .A17)~~

...

[Subsequent subparagraphs re-lettered. No amendment to paragraphs .15–.A16.]

Procedures for a Review of Interim Financial Information

...

Analytical Procedures, Inquiries, and Other Review Procedures

...

Inquiries and Other Review Procedures (Ref: par. .14)

...

.A17 ***When conducting a review of interim financial information, the auditor may decide to involve another auditor to provide information or to perform review procedures. For example, the auditor may involve component auditors in performing inquiries of management of a component. Additionally, the auditor may obtain from management reports of reviews of interim financial information of components of the reporting entity, including its investees.*** The auditor may find the guidance in ~~section 600~~***SAS No. 149***, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Referred-to Auditors***)*, useful in conducting a review of interim financial information for an entity that prepares group financial statements ***when component auditors are involved or when the group auditor makes reference to the review of a referred-to auditor***.

[No amendment to paragraphs .A18–.A54.]

Relevant Ethical Requirements (Ref: par. .31*d*(v))

...

.A55 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA code, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. ~~Section 600,~~***SAS No. 149,****Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors**), *fn11* provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor ***or referred-to auditor*** does not meet the independence requirements that are relevant to the group audit.

fn 11 Paragraphs ~~.22–.23~~ **27, 29, 47*c*, 51, 53, 62*a* and 63*b*** *of ~~section 600,~~* **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No amendment to paragraphs .A56–.A78.]

Exhibit B — Illustrations of Auditor's Review Reports on Interim Financial Information (Ref: par. .A44)

.A79

...

Illustration 3 — A Review Report That Refers to a ***Referred-to*** ~~Component~~ Auditor's Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

...

...

Illustration 3 — A Review Report That Refers to a *Referred-to* ~~Component~~ Auditor's Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.

- The auditor is making reference to ***a referred-to*** ~~another~~ auditor's review report on the interim financial information of a ~~significant~~ component of a reporting entity.

...

[No further amendment to AU-C section 930.]

Amendment to SAS No. 128, *Using the Work of Internal Auditors*, as Amended (AU-C sec. 610)

14. The amendment to AU-C section 610 is effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C Section 610, *Using the Work of Internal Auditors*

[No amendment to paragraphs .01–.A19.]

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

...

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used (Ref: par. .15–.18)

...

.A20

...

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) ***in determining the components at which audit work will be performed*** ~~and reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures~~ in accordance with the requirements of ***SAS No. 149,*** ~~section 600,~~ *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*.

[No further amendment to AU-C section 610.]

Amendment to SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended (AU-C sec. 940)

15. The amendment to AU-C section 940 is effective for integrated audits for periods ending on or after December 15, 2026.

AU-C Section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

[No amendment to paragraphs .01–.66.]

Report Modifications

.67 The auditor should modify the report on ICFR if any of the following conditions exist:

a. One or more material weaknesses exist.

b. Elements of management's report are incomplete or improperly presented.

c. There is a limitation on the scope of the engagement. (Ref: par. .A119)

d. The auditor decides to refer to the report of a ***referred-to*** ~~component~~ auditor as the basis, in part, for the auditor's own opinion.

e. There is other information contained in management's report.

[No amendment to paragraphs .68–.77.]

…

***Making Reference to a* Referred-to ~~*Component*~~ *Auditor and* Involving ~~*Assuming Responsibility for the Work of a*~~ *Component Auditors* in the Group Audit**

.78 ***In a group audit*** ~~When an entity includes one or more components~~, the group engagement partner should ***determine*** ~~evaluate~~ whether ~~the group engagement team will be able to obtain~~ sufficient appropriate audit evidence ***can reasonably be expected to be obtained (including through involving component auditors or through making reference to the audit of a referred-to auditor in the auditor's report on the ICFR over the group financial statements)*** ~~through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or making reference to the audit of ICFR of a component auditor in the auditor's report)~~ to ***provide a basis for forming an opinion on*** ~~act as the auditor of the ICFR over the group financial statements and report as such on~~ the ICFR over the group financial statements, as required by ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors**). *fn 9* (Ref: par. .A128) *fn 9 Paragraph* **19**~~*14*~~ *of* **SAS No. 149,** ~~*section 600,*~~ Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

.79 As required by ~~section 600,~~ ***SAS No. 149,*** the group engagement partner should determine whether to make reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the ***auditor's*** report on the ICFR over the group financial statements. *fn 10* Reference to the audit of a ***referred-to*** ~~component~~ auditor in the auditor's report on the ICFR over the group financial statements should not be made unless

a. the ***group*** engagement partner has determined that the ***referred-to*** ~~component~~ auditor has performed an audit of the component's ICFR in accordance with the relevant requirements of GAAS ~~(~~or~~, if applicable,~~ the standards promulgated by the PCAOB~~)~~ and

b. the ***referred-to*** ~~component~~ auditor has issued an auditor's report on ICFR that is not restricted as to use. (Ref: par. .A129–.A130) **fn 11**

fn 10 Paragraph ~~*.24*~~**55** *of* ~~*section 600,*~~ **SAS No. 149**.

fn 11 Paragraph 56 of SAS No. 149.

[Subsequent footnotes renumbered. No amendment to paragraph .80.]

Special Topics

Entities With Multiple Components

.81 In determining the components at which to perform tests of controls, the group ***auditor*** ~~engagement team~~ should ***take responsibility for the identification and*** assess***ment of*** the risk of material misstatement to the ***group*** financial statements associated with the component and correlate the amount of attention devoted to the component with the degree of risk. (Ref: par. .A133–.A135)

.82 In assessing and responding to risk, the group ***auditor*** ~~engagement team~~ should ***take responsibility for*** test***ing***~~, or have a component auditor test on the group engagement team's behalf,~~ controls over specific risks that present a reasonable possibility of material misstatement to the group financial statements. (Ref: par. .A136)

.83 In applying the requirement in paragraph .42 regarding special considerations for subsequent years' audits, the group ***auditor*** ~~engagement team~~ should vary the nature, timing, and extent of tests of controls at components from year to year.

[No amendment to paragraphs .84–.A127.]

Report Modifications (Ref: par. .67)

…

Making Reference to a **Referred-to** ~~***Component***~~ ***Auditor and*** **Involving** ~~***Assuming Responsibility for the Work of a***~~ ***Component Auditor*****s in the Group Audit** ***(Ref: par. .78–.79)***

.A128 ~~Section 600,~~***SAS No. 149*** addresses special considerations that apply to group audits, in particular those that involve component auditors ***or when reference is made to referred-to auditors***. ~~Section 600~~ ***SAS No. 149*** is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to multiple components discussed beginning in paragraphs .28 and .81.

.A129 The group engagement partner may ***determine*** ~~decide~~ to ***involve*** ~~assume responsibility for the work of the~~ component auditor***s*** or to make reference to the ***audit of a referred-to*** ~~component~~ auditor in the report on the ICFR over the group financial statements. The decision about whether to make reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the report on the audit of ICFR might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the group financial statements may make reference to the audit of a significant equity investment performed by a ***referred-to*** ~~component~~ auditor, but the report on the ICFR over the group financial statements might not make a similar reference because management's assessment about ICFR ordinarily would not extend to controls at the equity method investee. See paragraph .84 for further discussion of the evaluation of the controls for an equity method investment.

.A130 ~~Section 600~~ ***SAS No. 149*** establishes requirements and provides guidance when ***involving*** ~~assuming responsibility for the work of a~~ component auditor***s in a group audit*** and when making reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the auditor's report on the ***group*** financial statements that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in ~~section 600~~ ***SAS No. 149***. *fn 32*

fn 32 Illustration 4, "Unmodified Opinion on ICFR Making Reference to **the Audit of** *a* **Referred-to** ~~*Component*~~ *Auditor," of exhibit A.*

[No amendment to paragraphs .A131–.A132.]

Special Topics

Entities With Multiple Components (Ref: par. .81–.83)

.A133 As indicated in paragraph .A128 of this section, ~~section~~ ***SAS No. 149*** is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to components discussed in this section.

.A134 In determining the components at which ~~to perform~~ tests of controls ***will be performed***, the group ***auditor*** ~~engagement team~~ may also take into account work performed by the internal audit function or others on behalf of management. For example, if the internal audit function's planned procedures include relevant audit work at various components, the ***group*** auditor may ***decide to use that work in accordance***

with section 610~~coordinate work with the internal auditors and reduce the number of components at which the group engagement team, or a component auditor on the group engagement team's behalf, would otherwise need to perform audit procedures~~.

.A135 ~~The group engagement team may eliminate from further consideration components that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the group financial statements.~~ ***In the context of a group audit, the phrase "the group auditor should take responsibility for..." is used for those requirements when the group auditor is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors***.

.A136 ~~In lower risk components,~~ ***T***~~t~~he group ***auditor*** ~~engagement team first might~~ ***may*** evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides sufficient appropriate audit evidence ***for one or more relevant assertions for a significant class of transactions, account balance, or disclosure***. ~~The group engagement team or a component auditor on the group engagement team's behalf may test the operating effectiveness of controls over specific risks or group-wide controls.~~

[No amendment to paragraphs .A137–.A155.]

Exhibit A — Illustrative Reports

.A156 The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR
Illustration 2 — Adverse Opinion on ICFR
Illustration 3 — Disclaimer of Opinion on ICFR
Illustration 4 — Unmodified Opinion on ICFR Making Reference to ***the Audit of a Referred-to*** ~~a Component~~ Auditor
Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

…

Illustration 4 — Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to* ~~a Component~~ Auditor

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the ***audit*** ~~report~~ of a ***referred-to*** ~~component~~ auditor.

…

[No further amendment to AU-C section 940.]

Amendment to Various Sections in SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as Amended (AU-C secs. 700, 701, and 705)

AU-C Section 700, Forming an Opinion and Reporting on Financial Statements

16. The amendment to AU-C section 700 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A38.]

Auditor's Report (Ref: par. .21)

…

Auditor's Report for Audits Conducted in Accordance With GAAS

…

Basis for Opinion (Ref: par. .28)

…

.A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those relating to independence, in a group audit situation may be complex. ~~Section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors)**, *fn 21* provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor ***or referred-to auditor*** does not meet the independence requirements that are relevant to the group audit.

fn 21 *Paragraphs* ~~*22–23*~~ **27, 29, 47*c*, 51, 53, 62*a* and 63*b*** *of* ~~*section 600*~~**SAS No. 149**, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No amendment to paragraphs .A40–.A80.]

Exhibit — Illustrations of Auditor's Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)

.A81

...

Illustration 4 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the auditor's report.

...

[No further amendment to AU-C section 700.]

AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor's Report

17. The amendment to AU-C section 701 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A12.]

Determining Key Audit Matters (Ref: par. .08–.09)

...

Matters That Required Significant Auditor Attention (Ref: par. .08)

...

.A13 Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

a. *a.* Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance. *fn 7* For example, there may be potential difficulties relating to the following:

   i. i. *Related party transactions*. In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction. *fn 8*

ii. ii. *Limitations on the group audit*. For example, ~~the group engagement team's~~ access to information ***or people*** may be restricted. *fn 9*

fns 7–8 [Footnotes omitted for purposes of this SAS.]

fn 9 Paragraph ~~.49d~~ ***75c*** *of ~~section 600,~~* **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

...

[No further amendment to AU-C section 701.]

AU-C Section 705, Modifications to the Opinion in the Independent Auditor's Report

18. The amendment to AU-C section 705 is effective for audits of financial statements for periods ending on or after December 15, 2026.

[No amendment to paragraphs .01–.A10.]

Circumstances in Which a Modification to the Auditor's Opinion Is Required

...

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .07b)

...

.A11 Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.
- The accounting records of a ~~significant~~ component ***for which further audit procedures are determined to be necessary for purposes of the group audit*** have been seized indefinitely by governmental authorities.

[No amendment to paragraphs .A12–.A37.]

Exhibit — Illustrations of Auditor's Reports With Modifications to the Opinion

.A38

...

Illustration 3 — An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the auditor's report.

...

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Consolidated Financial Statements *fn 5*

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ***(the Company or ABC Company)***, which comprise the consolidated balance sheet as of December 31, 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the ***consolidated*** financial statements.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly the financial position of ***the***~~ABC~~Company ~~and its subsidiaries~~ as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

...

Auditor's Responsibilities for the Audit of the Financial Statements

...

In performing an audit in accordance with GAAS, we:

...

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the ***consolidated*** financial statements.

...

fn 5 [Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 705.]

Amendment to SAS No. 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, as Amended (AU-C sec. 720)

19. The amendment to AU-C section 720 is effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

[No amendment to paragraphs .01–.A1.]

Scope of This Section (Ref: par. .02 and .09)

...

.A2 Other AU-C sections provide requirements and guidance with respect to information in certain documents other than annual reports. For example, section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*; section 945, *Auditor Involvement With Exempt Offering Documents*; and ~~Statement on Auditing Standards No. 136~~ ***section 703***, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* ~~(sec. 703)~~. ~~*fn 3*~~

~~*fn 3* *Statement on Auditing Standards (SAS) No. 136,* Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA *(sec. 703), is effective for audits of financial statements for periods ending on or after December 15, 2021.*~~

[No amendment to paragraphs .A3–.A35.]

...

Reading and Considering the Other Information (Ref: par. .16–.17)

...

.A36 In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with ~~section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***)*, the group auditor decides to make reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the auditor's report on the group financial statements, *fn 10* the group auditor's knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

fn 10 *Paragraph* ~~*.24*~~**55** *of* ~~*section 600,*~~ **SAS No. 149,**Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No amendment to paragraphs .A37–.A38.]

.A39 The manner in which an auditor resolves a concern regarding whether other information is materially inconsistent with the auditor's knowledge obtained in the audit, is a matter of professional judgment. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team**,** ***including*** ~~or~~ relevant component auditors**,** is appropriate as a basis for the auditor's consideration of whether a material misstatement exists. Whether, and if so, the extent to which, the auditor refers to relevant audit documentation or makes inquiries of relevant members of the engagement team**,** ***including*** ~~or~~ relevant component auditors**,** is a matter of professional judgment.

.A40 It may not be necessary for the auditor to refer to relevant audit documentation or to make inquiries of relevant members of the engagement team**,** ***including*** ~~or~~ relevant component auditors**,** about any matter included in the other information. This may be the case, for example, when the group auditor decides to make reference to ***the audit of*** a ***referred-to*** ~~component~~ auditor in the auditor's report in accordance with ~~section 600~~ ***SAS No. 149,****fn11* and the group auditor has obtained sufficient knowledge in connection with the group audit about matters in the other information relating to the ~~significant~~ component with respect to which the ***referred-to*** ~~component~~ auditor has performed an audit of the financial statements.

fn 11 *Paragraph ~~.24~~***55** *of ~~section 600~~* **SAS No. 149**.

[No further amendment to AU-C section 720.]

Amendment to SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C sec. 315)

20. The amendment to SAS No. 145 is effective for audits of financial statements for periods ending on or after December 15, 2026.

AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

[No amendment to paragraphs .01–.A16.]

Risk Assessment Procedures and Related Activities (Ref: par. .13–.18)

.A17 The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this section. However, the significance of fraud is such that further requirements and guidance are included in section 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud. *fn 19* In addition, the following AU-C sections provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- Section 540, *Auditing Accounting Estimates and Related Disclosures*, with regard to accounting estimates

- Section 550, *Related Parties*, with regard to related party relationships and transaction***s***
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, with regard to going concern
- ~~Section 600,~~ ***SAS No. 149,*** *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors** *)*, with regard to group financial statements

fn 19 [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A18–.A52.]

Engagement Team Discussion (Ref: par. .17–.18)

...

Scalability

...

.A53 When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge and those ~~responsible for the~~ ***performing work at*** ~~audits of~~ components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed to by the engagement partner, may be useful.

[No amendment to paragraphs .A54–.A246.]

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .32–.41)

...

Assessing Risks of Material Misstatement at the Assertion Level

...

Significant Risks (Ref: par. .36)

Why Significant Risks Are Determined and the Implications for the Audit

.A247 The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk, through the performance of certain required responses, including the following:

...

- ~~Section 600~~ ***SAS No. 149*** requires ***the group auditor to evaluate the appropriateness of the design and performance of further audit procedures for areas of higher assessed risks of material misstatement of the group financial statements, or significant risks, on which a component auditor is determining the further audit procedures to be performed*** ~~more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor~~. *fn 65*

fn 65 *Paragraph* ~~*.57–.58*~~ **44** *of* ~~*section 600,*~~ **SAS No. 149,** Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors ***and Audits of Referred-to Auditors***).

[No further amendment to AU-C section 315.]

Amendment to SAS No. 146, *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C sec. 220)

21. The amendment to AU-C section 220 is effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025.

AU-C Section 220, *Quality Management for Engagements Conducted in Accordance With Generally Accepted Auditing Standards*

[No amendment to paragraphs .01–.41.]

Scope of This Section (Ref: par. .01)

.A1 This section applies to all audits of financial statements, including audits of group financial statements. ~~Section 600,~~ ***SAS No. 149,****Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors* **and Audits of Referred-to Auditors***), **addresses*** ~~deals with~~ special considerations that apply to an audit of group financial statements, including when component auditors are involved ***or when the group auditor makes reference to the audit of a referred-to auditor***. ~~Section 600~~ ***SAS No. 149*** also provides guidance on how to adapt and apply the requirements of this section in an audit of group financial statements involving component auditors. ~~Section 600~~ ***SAS No. 149,*** adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, ~~section 600~~ ***SAS No. 149*** may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

[No amendment to paragraphs .A2–.A21.]

Definitions

Engagement Team (Ref: par. 12)

...

.A22 When joint auditors conduct an audit, the joint engagement partners and their engagement teams collectively constitute the "engagement partner" and "engagement team" for purposes of GAAS. This section does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.

.A23 Referred-to auditors are not members of the engagement team. Referred-to auditors are not component auditors. **fn 25**

fn 25 Paragraph 16 of SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors).*

[Subsequent paragraphs and footnotes renumbered. No amendment to renumbered paragraphs .A24–.A25.]

The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. .08 and .17)

...

~~**.A24**~~ ***.A26*** In particular, the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes, and therefore, the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. ~~Paragraphs .22 and A47–A48 of section 600~~ ***SAS No. 149*** **fn 26** contain***s*** guidance on obtaining an understanding of the competence and capabilities of component auditors.

fn 26 Paragraphs 28 and A72–A76 of SAS No. 149.

...

[Subsequent footnotes further renumbered.]

~~**.A25**~~ ***.A27*** When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm's policies or procedures.

For example, in a group audit engagement, communicating the group auditor's policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified difficult or contentious matters that are relevant to the group financial statements to bring to the attention of the group ***auditor*** ~~engagement team~~.

[No amendment to renumbered paragraphs .A28–.A54.]

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. .22–.24)

...

~~**.A53**~~ ***.A55*** Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this section and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity's timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its ***entities or business units*** ~~components~~
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

~~**.A54**~~ ***.A56*** Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other sections, as well as this section, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by section 210, *Terms of Engagement fn* ~~*29*~~ **31**
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with section 315 and section 240, *Consideration of Fraud in a Financial Statement Audit*
- Understanding the group~~, its components,~~ and ***its*** ~~their~~ environments, in the case of an audit of group financial statements in accordance with ~~section 600~~ ***SAS No. 149***, and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor's specialist in accordance with section 620

- The entity's governance structure in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*, and section 265, *Communicating Internal Control Related Matters Identified in an Audit*

fn ~~29~~ **31** *[Footnote omitted for purposes of this SAS.]*

[No amendment to renumbered paragraphs .A57–.A61.]

Engagement Resources (Ref: par. .25–.28)

...

~~**.A60**~~ ***.A62*** Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances in which the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group ***auditor*** ~~engagement team~~. *fn ~~30~~* **32** In such circumstances, the firm's policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

fn ~~30~~ **32** *See paragraph ~~.03~~* **.A10** *of ~~section 600,~~* **SAS No. 149**.

[No amendment to renumbered paragraphs .A63–.A78.]

Insufficient or Inappropriate Resources (Ref: par. .27)

...

~~**.A77** ***.A79*** In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.~~

[No amendment to renumbered paragraphs .A80–.A93.]

Engagement Performance

...

The Engagement Partner's Review (Ref: par. .30–.34)

...

~~**.A93**~~ ***.A95*** The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

...

- In group audit situations,
  - — the overall group audit strategy and group audit plan;
  - — decisions about the involvement of component auditors, including how to direct and supervise them and review their work~~, including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component~~; and
  - — the evaluation of work performed by component auditors and the conclusions drawn therefrom

...

[No further amendment to renumbered paragraphs .A96–.A100.]

...

Review of Communications to Management, Those Charged With Governance, or Regulatory Authorities (Ref: par. 34)

~~**.A99**~~ ***.A101*** The engagement partner uses professional judgment in determining which written communications to review, taking into account the nature and circumstances of the audit engagement. For example:

- It may not be necessary for the engagement partner to review communications between the engagement team and management in the ordinary course of the audit.
- ***In group audit situations, the engagement partner may determine to review formal written communications to group management, those charged with governance of the group, or regulatory authorities relevant to the group.***

[No further amendment to AU-C section 220.]

AU-C Section 600A

Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)

Source: SAS No. 122; SAS No. 127; SAS No. 128; SAS No. 130; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 138; SAS No. 145.

See section 9600A for interpretations of this section.

Effective for audits of group financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 Generally accepted auditing standards (GAAS) apply to group audits. This section addresses special considerations that apply to group audits, in particular those that involve component auditors.

.02 An auditor may find this section, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.

.03 A component auditor may be required by law or regulation or may have been engaged by component management for another reason to express an audit opinion on the financial statements of a component. The requirements of this section apply, nonetheless, regardless of whether the group engagement partner decides to make reference to the component auditor in the auditor's report on the group financial statements or to assume responsibility for the work of component auditors.

.04 Governmental entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.

.05 In accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively possess the appropriate competence and capabilities.[1] The group engagement partner also is responsible for the direction, supervision, and performance of the group audit engagement. In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

.06 The requirements of section 220A apply regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This section assists the group engagement partner to meet the requirements of section 220A when component auditors perform work on the financial information of components.

.07 Audit risk is a function of the risk of material misstatement of the financial statements and the risk that the auditor will not detect such misstatements.[2] In a group audit, detection risk includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements and the risk that the group engagement team may not detect this misstatement. This section explains the matters that the group engagement team considers when determining the nature, timing, and extent of its involvement in the risk assessment procedures and further audit procedures performed by the component auditors on the financial information of the components. The purpose of this involvement is to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial statements.

.08 The group engagement partner is responsible for deciding, individually for each component, to either

---

[1]Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .A36 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

- assume responsibility for, and thus be required to be involved in, the work of a component auditor, insofar as that work relates to the expression of an opinion on the group financial statements, or
- not assume responsibility for, and accordingly make reference to, the audit of a component auditor in the auditor's report on the group financial statements.

The requirements in paragraphs .51–.65 are applicable only when the auditor of the group financial statements is assuming responsibility for the work of component auditors. All other requirements in this section apply to all audits of group financial statements.

Effective Date

.09 This section is effective for audits of group financial statements for periods ending on or after December 15, 2012.

Objectives

.10 The objectives of the auditor are to determine whether to act as the auditor of the group financial statements and, if so, to

a. determine whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements;

b. communicate clearly with component auditors; and

c. obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion about whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Definitions

.11 For purposes of GAAS, the following terms have the meanings attributed as follows:

Component. An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements. (Ref: par. .A1–.A5)

Component auditor. An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner's firm, a network firm of the group engagement partner's firm, or another firm. (Ref: par. .A9–.A11)

Component management. Management responsible for preparing the financial information of a component.

Component materiality. The materiality for a component determined by the group engagement team for the purposes of the group audit.

Group. All the components whose financial information is included in the group financial statements. A group always has more than one component.

Group audit. The audit of group financial statements.

Group audit opinion. The audit opinion on the group financial statements.

Group engagement partner. The partner or other person in the firm[3] who is responsible for the group audit engagement and its performance and for the auditor's report on the group financial statements that is issued on behalf of the firm. When joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. This section does not, however, address the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.

Group engagement team. Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

Group financial statements. Financial statements that include the financial information of more than one component. The term *group financial statements* also refers to combined financial statements aggregating the financial information prepared by components that are under common control.

Group management. Management responsible for the preparation and fair presentation of the group financial statements.

Group-wide controls. Controls designed, implemented, and maintained by group management over group financial reporting.

Significant component. A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. (Ref: par. .A6–.A8)

.12 Reference to *the applicable financial reporting framework* means the financial reporting framework that applies to the group financial statements. Reference to *the consolidation process* includes the following:

a. The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of inclusion, consolidation, proportionate consolidation, or the equity or cost methods of accounting (Ref: par. .A12)

b. The aggregation in combined financial statements of the financial information of components that are under common control

[3]*Group engagement partner* and *firm* refer to their governmental equivalents when relevant.

Requirements

Responsibility

.13 In accordance with section 220A, the group engagement partner is responsible for (1) the direction, supervision, and performance of the group audit engagement in compliance with professional standards, applicable regulatory and legal requirements, and the firm's policies and procedures; and (2) determining whether the auditor's report that is issued is appropriate in the circumstances.[4] (Ref: par. .A13–.A14)

Acceptance and Continuance

.14 The group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained regarding the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team should obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. (Ref: par. .A15–.A17)

.15 The group engagement partner should evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or through making reference to the audit of a component auditor in the auditor's report), to act as the auditor of the group financial statements and report as such on the group financial statements. (Ref: par. .A18–.A21)

.16 In some circumstances, the group engagement partner may conclude that it will not be possible, due to restrictions imposed by group management, for the group engagement team to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors, and the possible effect of this inability, will result in a disclaimer of opinion on the group financial statements.[5] In such circumstances, the auditor of the group financial statements should

- in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement when withdrawal is possible under applicable law or regulation, or
- when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: par. .A22–.A27)

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[4]Paragraph .17 of section 220A.

[5]Paragraphs .11–.14 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Terms of Engagement

.17 The auditor of the group financial statements is required, in accordance with section 210A, *Terms of Engagement*, to agree upon the terms of the group audit engagement.[6] (Ref: par. .A28–.A29)

Overall Audit Strategy and Audit Plan

.18 The group engagement team should establish an overall group audit strategy and should develop a group audit plan. In developing the group audit plan, the group engagement team should assess the extent to which the group engagement team will use the work of component auditors and whether the auditor's report on the group financial statements will make reference to the audit of a component auditor, as discussed in paragraphs .24–.30.

.19 The group engagement partner should review and approve the overall group audit strategy and group audit plan. (Ref: par. .A30)

Understanding the Group, Its Components, and Their Environments

.20 The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment, the applicable reporting framework, and the system of internal control.[7] The group engagement team should

a. enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage.

b. obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: par. .A31–.A37)

[As amended, effective for audits of group financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.21 The group engagement team should obtain an understanding that is sufficient to

a. confirm or revise its initial identification of components that are likely to be significant.

b. assess the risks of material misstatement of the group financial statements, whether due to fraud or error.[8] (Ref: par. .A38–.A39)

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[6]Paragraph .09 of section 210A, *Terms of Engagement*.

[7]See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[8]See section 315A.

Understanding a Component Auditor

.22 Regardless of whether reference will be made in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain an understanding of the following: (Ref: par. .A40–.A44)

a. Whether a component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent (Ref: par. .A46)

b. A component auditor's professional competence (Ref: par. .A47–.A48)

c. The extent, if any, to which the group engagement team will be able to be involved in the work of the component auditor

d. Whether the group engagement team will be able to obtain information affecting the consolidation process from a component auditor

e. Whether a component auditor operates in a regulatory environment that actively oversees auditors (Ref: par. .A45)

.23 When a component auditor does not meet the independence requirements that are relevant to the group audit or the group engagement team has serious concerns about the other matters listed in paragraph .22*a–b*, the group engagement team should obtain sufficient appropriate audit evidence relating to the financial information of the component without making reference to the audit of that component auditor in the auditor's report on the group financial statements or otherwise using the work of that component auditor. (Ref: par. .A49–.A51)

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements

.24 Having gained an understanding of each component auditor, the group engagement partner should decide whether to make reference to a component auditor in the auditor's report on the group financial statements. (Ref: par. .A52)

.25 Reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

a. the group engagement partner has determined that the component auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS (Ref: par. .A53), and

b. the component auditor has issued an auditor's report that is not restricted as to use.[9]

[As amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

[9] See section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 125.]

.26 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

a. the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and

b. the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. (Ref: par. .A54–.A57)

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.27 When the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain sufficient appropriate audit evidence with regard to such components by performing the following procedures:

a. The procedures required by this section, except for those required by paragraphs .51–.65

b. Reading the component's financial statements and the component auditor's report thereon to identify significant findings and issues and, when considered necessary, communicating with the component auditor in this regard

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Making Reference in the Auditor's Report

.28 When the group engagement partner decides to make reference to the audit of a component auditor in the auditor's report on the group financial statements, the report on the group financial statements should clearly indicate

a. that the component was not audited by the auditor of the group financial statements but was audited by the component auditor.

b. the magnitude of the portion of the financial statements audited by the component auditor.

c. when the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements

i. the financial reporting framework used by the component and

ii. that the auditor of the group financial statements is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group.

d. when

i. the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and

ii. the group engagement partner has determined that the component auditor performed additional audit procedures in order to meet the relevant requirements of GAAS

1. the set of auditing standards used by the component auditor and

2. that additional audit procedures were performed by the component auditor to meet the relevant requirements of GAAS. (Ref: par. .A58–.A60)

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.29 If the group engagement partner decides to name a component auditor in the auditor's report on the group financial statements

a. the component auditor's express permission should be obtained.

b. the component auditor's report should be presented together with that of the auditor's report on the group financial statements.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.30 If the opinion of a component auditor is modified or that report includes an emphasis-of-matter or other-matter paragraph, the auditor of the group financial statements should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the auditor of the group financial statements should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the group financial statements. (Ref: par. .A61) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.31 If the group engagement partner decides to assume responsibility for work of a component auditor, no reference should be made to the component auditor in the auditor's report on the group financial statements. (Ref: par. .A62) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality

.32 The group engagement team should determine the following: (Ref: par. .A63)

a. Materiality, including performance materiality, for the group financial statements as a whole when establishing the overall group audit strategy.[10]

b. Whether, in the specific circumstances of the group, particular classes of transactions, account balances, or disclosures in the group financial statements exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the group financial statements as a whole would influence the judgment made by a reasonable user based on the group financial statements. In such circumstances, the group engagement team should determine materiality to be applied to those particular classes of transactions, account balances, or disclosures.

c. Component materiality for those components on which the group engagement team will perform, or for which the auditor of the group financial statements will assume responsibility for the work of a component auditor who performs, an audit or a review. Component materiality should be determined taking into account all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of a component auditor. To reduce the risk that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds the materiality for the group financial statements as a whole, component materiality should be lower than the materiality for the group financial statements as a whole, and component performance materiality should be lower than performance materiality for the group financial statements as a whole. (Ref: par. .A64–.A66)

d. The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: par. .A67)

See paragraph .51 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

Responding to Assessed Risks

.33 The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements.[11] If the nature, timing, and extent of the work to be performed on the consolidation process or the financial information of the components is based on an expectation that group-wide controls

[10]See section 320, *Materiality in Planning and Performing an Audit*.

[11]See section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

are operating effectively or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the group engagement team should test, or have a component auditor test on the group engagement team's behalf, the operating effectiveness of those controls. See paragraphs .52–.58 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A68) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Consolidation Process

.34 In accordance with paragraph .20, the group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. In accordance with paragraph .33, the group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing, and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.35 The group engagement team should design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include evaluating whether all components have been included in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.36 The group engagement team should evaluate the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications and should evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: par. .A69) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.37 If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group engagement team should evaluate whether the financial information of that component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A57) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.38 The group engagement team should determine whether the financial information identified in a component auditor's communication (see paragraph .42*b*) is the financial information that is incorporated in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.39 If the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the group engagement team should evaluate whether appropriate adjustments have been made to those financial statements in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events

.40 When the group engagement team or component auditors perform audits on the financial information of components, the group engagement team or the component auditors should perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements and that may require adjustment to, or disclosure in, the group financial statements. See paragraph .59 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A70) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor

.41 The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should include the following:

a. A request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirm that the component auditor will cooperate with the group engagement team.

b. The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.

c. A list of related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties. The group engagement team should request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.

d. Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.42 The group engagement team should request a component auditor to communicate matters relevant to the group engagement team's conclusion, with regard to the group audit. Such communication should include the following:

a. Whether the component auditor has complied with ethical requirements relevant to the group audit, including independence and professional competence

b. Identification of the financial information of the component on which the component auditor is reporting

c. The component auditor's overall findings, conclusions, or opinion

See paragraphs .60–.61 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Evaluating a Component Auditor's Communication and Adequacy of Their Work

.43 The group engagement team should evaluate a component auditor's communication (see paragraph .42). The group engagement team should discuss significant findings and issues arising from that evaluation with the component auditor, component management, or group management, as appropriate. See paragraphs .60–.63 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Sufficiency and Appropriateness of Audit Evidence

.44 The auditor is required to obtain sufficient appropriate audit evidence on which to base the audit opinion.[12] The group engagement team should evaluate whether sufficient appropriate audit evidence on which to base the group audit opinion has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components. (Ref: par. .A71) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.45 The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (either identified by the group engagement team or communicated by component auditors) and any instances in which there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. .A72) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management and Those Charged With Governance

.46 The group engagement team should communicate to group management and those charged with governance of the group material weaknesses and significant deficiencies in internal control that are relevant to the group (either identified by the group engagement team or brought to its attention by a component auditor during the audit), in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

[12] Paragraph .19 of section 200.

.47 If fraud has been identified by the group engagement team or brought to its attention by a component auditor or information indicates that a fraud may exist, the group engagement team should communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. .A73) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.48 When a component auditor has been engaged to express an audit opinion on the financial statements of a component, the group engagement team should request group management to inform component management of any matter of which the group engagement team becomes aware that may be significant to the financial statements of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the group engagement team should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group engagement team, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the component until the matter is resolved and whether to withdraw from the engagement. (Ref: par. .A74) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group

.49 The group engagement team should communicate the following matters with those charged with governance of the group, in addition to those required by section 260, *The Auditor's Communication With Those Charged With Governance*, and other AU-C sections: (Ref: par. .A75)

a. An overview of the type of work to be performed on the financial information of the components, including the basis for the decision to make reference to the audit of a component auditor in the auditor's report on the group financial statements

b. An overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components

c. Instances in which the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work

d. Any limitations on the group audit (for example, when the group engagement team's access to information may have been restricted)

e. Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls, or others in which a material misstatement of the group financial statements has or may have resulted from fraud

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation

.50 The group engagement team should include in the audit documentation the following:[13]

a. An analysis of components indicating those that are significant and the type of work performed on the financial information of the components

b. Those components for which reference to the reports of component auditors is made in the auditor's report on the group financial statements

c. Written communications between the group engagement team and the component auditors about the group engagement team's requirements

d. For those components for which reference is made in the auditor's report on the group financial statements to the audit of a component auditor

   i. the financial statements of the component and the report of the component auditor thereon

   ii. when the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the component auditor met the relevant requirements of GAAS

See paragraph .65 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (See paragraph .32)

.51 In the case of an audit of the financial information of a component in which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should evaluate the appropriateness of performance materiality at the component level. (Ref: par. .A76–.A77) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Determining the Type of Work to Be Performed on the Financial Information of Components (See paragraph .33)

.52 For components for which the auditor of the group financial statements is assuming responsibility for the work of component auditors, the group engagement team should

[13]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

determine the type of work to be performed by the group engagement team or by component auditors on its behalf on the financial information of the components (see paragraphs .53–.56). The group engagement team also should determine the nature, timing, and extent of its involvement in the work of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Significant Components

.53 For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, should perform an audit of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality. (Ref: par. .A78) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.54 For a component that is significant not due to its individual financial significance but because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, should perform one or more of the following: (Ref: par. .A79)

a. An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
b. An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A80)
c. Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A81)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components

.55 For components that are not significant components, the group engagement team should perform analytical procedures at the group level. (Ref: par. .A82) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.56 In some circumstances, the group engagement team may determine that sufficient appropriate audit evidence on which to base the group audit opinion will not be obtained from the following:

a. The work performed on the financial information of significant components
b. The work performed on group-wide controls and the consolidation process
c. The analytical procedures performed at group level

In such circumstances, the group engagement team should select additional components that are not significant components and should perform or request a component auditor to perform one or more of the following on the financial information of the individual components selected: (Ref: par. .A83–.A86)

- An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
- An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures
- A review of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality
- Specified audit procedures

The group engagement team should vary the selection of such individual components over a period of time. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Involvement in the Work Performed by Component Auditors (Ref: par. .A87–.A88)

Significant Components — Risk Assessment

.57 When a component auditor performs an audit or other specified audit procedures of the financial information of a significant component for which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should be involved in the risk assessment of the component to identify significant risks of material misstatement of the group financial statements. The nature, timing, and extent of this involvement are affected by the group engagement team's understanding of the component auditor but, at a minimum, should include the following:

a. Discussing with the component auditor or component management the component's business activities of significance to the group.
b. Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error.
c. Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the component auditor's conclusion with regard to the identified significant risks.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Identified Significant Risks of Material Misstatement of the Group Financial Statements — Further Audit Procedures

.58 When significant risks of material misstatement of the group financial statements have been identified in a component for which the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the group engagement team should evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements. Based on its understanding of the component auditor, the group engagement team should determine whether it is necessary to be involved in the further audit procedures. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (See paragraph .40)

.59 When component auditors perform work other than audits of the financial information of components at the request of the group engagement team, the group engagement team should request the component auditors to notify the group engagement team if they become aware of events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements that may require an adjustment to, or disclosure in, the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (See paragraph .42)

.60 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication required in paragraph .41 should set out the work to be performed and the form and content of the component auditor's communication with the group engagement team. It also should include, in the case of an audit or review of the financial information of the component, component materiality (and the amount or amounts lower than the materiality for particular classes of transactions, account balances, or disclosures, if applicable) and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: par. .A89–.A92) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.61 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication requested from the component auditor, as required in paragraph .42, also should include the following:

a. Whether the component auditor has complied with the group engagement team's requirements.

b. Information on instances of noncompliance with laws or regulations at the component or group level that could give rise to a material misstatement of the group financial statements.

c. Significant risks of material misstatement of the group financial statements, due to fraud or error, identified by the component auditor in the component and the component auditor's responses to such risks. The group engagement team should request the component auditor to communicate such significant risks on a timely basis.

d. A list of corrected and uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the threshold for clearly trivial misstatements communicated by the group engagement team).

e. Indicators of possible management bias regarding accounting estimates and the application of accounting principles.

f. Description of any identified material weaknesses and significant deficiencies in internal control at the component level.

g. Other significant findings and issues that the component auditor communicated or expects to communicate to those charged with governance of the component, including fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level, or others that resulted in a material misstatement of the financial information of the component.

h. Any other matters that may be relevant to the group audit or that the component auditor wishes to draw to the attention of the group engagement team, including exceptions noted in the written representations that the component auditor requested from component management.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating a Component Auditor's Communication and Adequacy of Their Work (See paragraph .43)

.62 The group engagement team should determine, based on the evaluation required in paragraph .43, whether it is necessary to review other relevant parts of a component auditor's audit documentation. (Ref: par. .A93) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.63 If the group engagement team concludes that the work of a component auditor is insufficient, the group engagement team should determine additional procedures to be performed and whether they are to be performed by the component auditor or by the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group (See paragraphs .46–.49)

.64 The group engagement team should determine which material weaknesses and significant deficiencies in internal control that component auditors have brought to the attention of the group engagement team should be communicated to group management and those charged with governance of the group. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation (See paragraph .50)

.65 The group engagement team should include in the audit documentation the nature, timing, and extent of the group engagement team's involvement in the work performed by the component auditors on significant components, including, when applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Application and Other Explanatory Material

Definitions

Component (Ref: par. .11)

.A1 The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organizational structure that provides for financial information to be prepared by a parent and one or more subsidiaries, joint ventures, or investees accounted for by the equity or cost methods of accounting; by a head office and one or more divisions or branches; or by a combination of both. Some groups, however, may organize their financial reporting system by function, process, product or service (or by groups of products or services), or geographical locations. In these cases, the entity or business activity for which group or component management prepares financial information that is included in the group financial statements may be a function, process, product or service (or group of products or services), or geographical location.

.A2 An investment accounted for under the equity method constitutes a component for purposes of this section. Investments accounted for under the cost method may be analogous to a component for purposes of this section when the work and reports of other auditors constitute a major element of evidence for such investments.

.A3 Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to identify components at certain levels of aggregation rather than individually.

.A4 Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component also may prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This section may, therefore, be applied by different group engagement partners and teams for different subgroups within a larger group.

Considerations Specific to Audits of Governmental Entities

.A5 In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

Significant Component (Ref: par. .11)

.A6 As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, revenues, expenditures, or net income. For example, the group engagement team may consider that components exceeding a specified percentage of the chosen benchmark are significant components.

.A7 The group engagement team also may identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances.[14] For example, a component could be responsible for foreign exchange trading and, thus, expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group. [As amended, effective for audits of group financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Considerations Specific to Governmental Entities

.A8 In audits of governmental entities, appropriate quantitative benchmarks for identifying significant components might include net costs or total budget. Qualitative considerations in audits of governmental entities may involve matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue.

Component Auditor (Ref: par. .11)

.A9 For purposes of this section, auditors who do not meet the definition of a member of the group engagement team are considered to be component auditors. However, an auditor who performs work on a component when the group engagement team will not use that work to provide audit evidence for the group audit is not considered a component auditor.

.A10 When two or more component auditors exist, the provisions of this section are applicable to each component auditor.

.A11 A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. When this is the case, such a member of the group engagement team also is a component auditor.

Consolidation Process (Ref: par. .12)

Considerations Specific to Governmental Entities

.A12 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

Responsibility (Ref: par. .13)

.A13 Component auditors may perform work on the financial information of the components for the group audit and, as such, are responsible for their overall findings, conclusions, or opinions. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a component auditor, the auditor of the group financial statements is responsible for the group audit opinion.

[14] [Footnote deleted by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Governmental Entities

.A14 When the auditor of the group financial statements is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements, the auditor's reporting responsibilities with respect to the separate financial statements are the same as the auditor's responsibilities with respect to the group financial statements.

Acceptance and Continuance

Obtaining an Understanding at the Acceptance or Continuance Stage (Ref: par. .14)

.A15 In the case of a new engagement, the group engagement team's understanding of the group, its components, and their environments may be obtained from the following:

- Information provided by group management
- Communication with group management
- When applicable, communication with the previous group engagement team, component management, or component auditors

.A16 The group engagement team's understanding may include matters such as the following:

- The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized)
- Components' business activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place
- The use of service organizations, including shared service centers
- A description of group-wide controls
- The complexity of the consolidation process
- Whether component auditors that are not from the group engagement partner's firm or network will perform work on the financial information of any of the components and group management's rationale for engaging more than one auditor, if applicable
- Whether the group engagement team
    - — will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, component information, and the component auditors (including relevant audit documentation sought by the group engagement team)
    - — will be able to perform necessary work on the financial information of the components

.A17 In the case of a continuing engagement, the group engagement team's ability to obtain sufficient appropriate audit evidence may be affected by significant changes, such as the following:

- Changes in the group structure (for example, acquisitions, disposals, reorganizations, or changes in how the group financial reporting system is organized)
- Changes in components' business activities that are significant to the group
- Changes in the composition of those charged with governance of the group, group management, or key management of significant components
- Concerns the group engagement team has with regard to the integrity and competence of group or component management
- Changes in group-wide controls
- Changes in the applicable financial reporting framework

Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .15)

.A18 Relevant factors in determining whether to act as the auditor of the group financial statements include, among other things, the following:

- The individual financial significance of the components, as determined in accordance with the guidance in paragraph .A6, for which the auditor of the group financial statements will be assuming responsibility
- The extent to which significant risks of material misstatement of the group financial statements are included in the components for which the auditor of the group financial statements will be assuming responsibility
- The extent of the group engagement team's knowledge of the overall financial statements

.A19 A group may consist only of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team will be able to

a. perform the work on the financial information of some of these components.

b. use the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

.A20 When the auditor of the group financial statements is assuming responsibility for the work performed by a component auditor, the group engagement team is required by the provisions of this section to be involved in the work of the component auditor. Paragraph .27 describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor.

Considerations Specific to Governmental Entities

.A21 Additional factors in determining whether to act as the auditor of the group financial statements in audits of state and local governments include, the following:

- Engagement by the primary government as the auditor of the financial reporting entity
- Responsibility for auditing the primary government's general fund (or other primary operating fund)

Access to Information (Ref: par. .16)

.A22 The group engagement team's access to information may be restricted by group management, or it may be restricted by circumstances that cannot be overcome by group management (for example, laws relating to confidentiality and data privacy or denial by a component auditor of access to relevant audit documentation sought by the group engagement team).

.A23 When access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component and the group engagement team has a complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component. If the component is a significant component, however, and the auditor of the group financial statements is not making reference to the audit of a component auditor in the auditor's report on the group financial statements, then the group engagement team will not be able to comply with the requirements of this section that are relevant in the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs .57–.58 to be involved in the work of a component auditor. Therefore, the group engagement team will not be able to obtain sufficient appropriate audit evidence regarding that component. The effect on the auditor's report of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.A24 The group engagement team will not be able to obtain sufficient appropriate audit evidence if group management restricts the access of the group engagement team or a component auditor to the information of a significant component.

.A25 Although the group engagement team may be able to obtain sufficient appropriate audit evidence if such restriction relates to a component considered not a significant component, the reason for the restriction may affect the group audit opinion. For example, it may affect the reliability of group management's responses to the group engagement team's inquiries and group management's representations to the group engagement team.

.A26 Section 210A addresses circumstances when an entity is required by law or regulation to have an audit.[15] In these circumstances, this section still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705.

.A27 Exhibit A, "Illustrations of Auditor's Reports on Group Financial Statements," contains an example of an auditor's report containing a qualified opinion based on the group engagement team's inability to obtain sufficient appropriate audit evidence regarding a significant component accounted for by the equity method of accounting when, in the group engagement team's professional judgment, the effect is material but not pervasive.

Terms of Engagement (Ref: par. .17)

.A28 The terms of engagement identify the applicable financial reporting framework.[16] Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a component auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communication between the group engagement team and component auditors to the extent permitted by law or regulation
- Communication to the group engagement team of important communications between
  - — the component auditors, those charged with governance of the component, and component management, including communications on significant deficiencies and material weaknesses in internal control
  - — regulatory authorities and components related to financial reporting matters
- To the extent the group engagement team considers necessary
  - — access to component information, those charged with governance of components, component management, and the component auditors (including relevant audit documentation sought by the group engagement team)
  - — permission to perform work, or request a component auditor to perform work, on the financial information of the components

.A29 Certain restrictions imposed after acceptance of the group audit engagement result in an inability to obtain sufficient appropriate audit evidence that may affect the group audit opinion including, specifically, restrictions imposed on the following:

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[15] Paragraphs .07 and .A19 of section 210A.

[16] Paragraph .10 of section 210A.

- The group engagement team's access to component information, those charged with governance of components, component management, or the component auditors (including relevant audit documentation sought by the group engagement team)
- The work to be performed on the financial information of the components

These restrictions may even lead to withdrawal from the engagement unless that is not possible under law or regulation. Section 705 addresses the auditor's responsibilities when management has imposed a limitation on the scope of the audit after the auditor has accepted the engagement.[17]

Overall Audit Strategy and Audit Plan (Ref: par. .19)

.A30 The group engagement partner's review of the overall group audit strategy and group audit plan is an important part of fulfilling the group engagement partner's responsibility for the direction of the group audit engagement.

Understanding the Group, Its Components, and Their Environments

Matters About Which the Group Engagement Team Obtains an Understanding (Ref: par. .20)

.A31 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.[18]Appendix A, "Understanding the Group, Its Components, and Their Environments — Examples of Matters About Which the Group Engagement Team Obtains an Understanding," of this section contains guidance on matters specific to a group, including the consolidation process.

Instructions Issued by Group Management to Components (Ref: par. .20)

.A32 To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information of the components to be included in the group financial statements and often include financial reporting procedures manuals and a reporting package. A reporting package ordinarily consists of standard formats for providing financial information for incorporation in the group financial statements. Reporting packages generally do not, however, take the form of complete financial statements prepared and presented in accordance with the applicable financial reporting framework.

.A33 The instructions ordinarily cover the following:

[17] Paragraphs .11–.14 and .A15–.A16 of section 705.

[18] Paragraphs .A17–.A41 of section 315A.

- The accounting policies to be applied
- Statutory and other disclosure requirements applicable to the group financial statements, including the following:
  - — The identification and reporting of segments
  - — Related party relationships and transactions
  - — Intragroup transactions and unrealized profits or losses
  - — Intragroup account balances
- A reporting timetable

.A34 The group engagement team's understanding of the instructions may include the following:

- The clarity and practicality of the instructions for completing the reporting package
- Whether the instructions
  - — adequately describe the characteristics of the applicable financial reporting framework
  - — provide for disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework (for example, disclosure of related party relationships, related party transactions, and segment information)
  - — provide for the identification of consolidation adjustments (for example, intragroup account balances, transactions, and unrealized profits or losses)
  - — provide for the approval of the financial information by component management

Fraud (Ref: par. .20)

.A35 The auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud and to design and implement appropriate responses to the assessed risks.[19] Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements may be materially misstated as a result of fraud
- Group management's process for identifying and responding to the risks of fraud in the group, including any specific fraud risks identified by group management or account balances, classes of transactions, or disclosures for which a risk of fraud is likely
- Whether particular components exist for which a risk of fraud is likely

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[19]See section 240, *Consideration of Fraud in a Financial Statement Audit*.

- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group and the controls group management has established to mitigate these risks
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and, if considered appropriate, component management, the component auditors, and others) to the group engagement team's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Discussion Among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: par. .20)

.A36 The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions also may include the component auditors.[20,21] The group engagement partner's determination of who to include in the discussions, how and when they occur, and their extent is affected by factors, such as prior experience with the group.

.A37 The discussions provide an opportunity to

- share knowledge of the components and their environments, including group-wide controls.
- exchange information about the business risks of the components or the group.
- exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error; how group management and component management could perpetrate and conceal fraudulent financial reporting; and how assets of the components could be misappropriated.
- identify practices followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting (for example, revenue recognition practices that do not comply with the applicable financial reporting framework).
- consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud; provide the opportunity for fraud to be perpetrated; or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.

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[20]Paragraph .15 of section 240.

[21]Paragraph .11 of section 315A.

- consider the risk that group or component management may override controls.
- consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- discuss fraud that has been identified in components or information that indicates the existence of a fraud in a component.
- share information that may indicate noncompliance with laws or regulations (for example, payments of bribes and improper transfer pricing practices).

Risk Factors (Ref: par. .21)

.A38 Appendix B, "Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements," sets out examples of conditions or events that, individually or together, may indicate risks of material misstatement of the group financial statements, including risks due to fraud.

Risk Assessment (Ref: par. .21)

.A39 The group engagement team's assessment at group level of the risks of material misstatement of the group financial statements is based on information, such as the following:

- Information obtained from the understanding of the group, its components, and their environments and of the consolidation process, including audit evidence obtained in evaluating the design and implementation of group-wide controls and controls that are relevant to the consolidation
- Information obtained from the component auditors

Understanding a Component Auditor (Ref: par. .22)

Group Engagement Team's Procedures to Obtain an Understanding of a Component Auditor and Sources of Audit Evidence (Ref: par. .22)

.A40 Factors that may affect the group engagement partner's decisions whether to use the work of a component auditor to provide audit evidence for the group audit and whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements include the following:

- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable

- Differences in the auditing and other standards applied by the component auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group engagement team to be involved in the work of a component auditor

.A41 It will not be necessary to obtain an understanding of the auditors of those components for which the group engagement team plans to perform analytical procedures at group level only.

.A42 The nature, timing, and extent of the group engagement team's procedures to obtain an understanding of a component auditor are affected by factors, such as previous experience with, or knowledge of, the component auditor and the degree to which the group engagement team and the component auditor are subject to common policies and procedures, such as the following:

- Whether the group engagement team and a component auditor share the following:
  - — Common policies and procedures for performing the work (for example, audit methodologies)
  - — Common quality control policies and procedures
  - — Common monitoring policies and procedures
- The consistency or similarity of the following:
  - — Laws and regulations or legal system
  - — Professional oversight, discipline, and external quality assurance
  - — Education and training
  - — Professional organizations and standards
  - — Language and culture

.A43 These factors interact and are not mutually exclusive. For example, the extent of the group engagement team's procedures to obtain an understanding of component auditor A, who consistently applies common quality control and monitoring policies and procedures and a common audit methodology or operates in the same jurisdiction as the auditor of the group financial statements, may be less than the extent of the group engagement team's procedures to obtain an understanding of component auditor B, who does not consistently apply common quality control and monitoring policies and procedures and a common audit methodology or operates in a different jurisdiction. The nature of the procedures performed regarding component auditors A and B also may be different.

.A44 The group engagement team may obtain an understanding of a component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example

- determine through communication with a component auditor that
  - — the component auditor is aware that
    - the financial statements of the component are to be included in the group financial statements on which the auditor of the group financial statements will report.
    - the component auditor's report thereon will be relied upon by the auditor of the group financial statements.
    - either the auditor of the group financial statements will make reference to the component auditor's report in the opinion on the group financial statements or the group engagement team will be involved in the work of the component auditor.
- a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.
- evaluate the results of the quality control monitoring system when the group engagement team and component auditor are from a firm or network that operates under, and complies with, common monitoring policies and procedures.[22]
- visit a component auditor to discuss the matters in paragraph .22*a–d*.
- request a component auditor to confirm the matters referred to in paragraph .22*a–d* in writing. Exhibit B, "Illustrative Component Auditor's Confirmation Letter," contains an example of written confirmations by a component auditor.
- request a component auditor to complete questionnaires about the matters in paragraph .22*a–d*.
- discuss a component auditor with colleagues in the group engagement partner's firm or with a reputable third party that has knowledge of the component auditor, such as other practitioners or bankers and other credit grantors.

In subsequent years, the understanding of a component auditor may be based on the group engagement team's previous experience with that component auditor. The group engagement team may request the component auditor to confirm whether anything regarding the matters listed in paragraph .22*a–d* has changed since the previous year.

.A45 Where independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits, awareness of the regulatory environment may assist the group engagement team in evaluating the independence and competence of a component auditor. Information about the regulatory environment and the public results of any inspections performed by oversight bodies may be obtained from the component auditor or information provided by the independent oversight bodies.

[22]Paragraph .57 of QM section 10A, *A Firm's System of Quality Control*.

Ethical Requirements That Are Relevant to the Group Audit (Ref: par. .22a)

.A46 When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements that are relevant to the group audit. Such requirements may be different or in addition to those applying to the component auditor when performing an audit in the component auditor's jurisdiction. The group engagement team, therefore, obtains an understanding about the component auditor's understanding of, and compliance with, the ethical requirements that are relevant to the group audit and whether that is sufficient to fulfill the component auditor's responsibilities in the group audit. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.[23] [Revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

A Component Auditor's Professional Competence (Ref: par. .22b)

.A47 Inquiries about the professional reputation and standing of a component auditor may be made of the AICPA, the state board of accountancy by which the component auditor is licensed, the applicable state society of CPAs, or the local chapter, or, in the case of an auditor from a foreign jurisdiction, the corresponding professional organization, and if applicable, the PCAOB. The group engagement team may obtain the peer review report, if available, on the component auditor's firm. Exhibit C, "Sources of Information," provides information about specific inquires that may be directed to the AICPA.

.A48 The group engagement team's understanding of a component auditor's professional competence may include whether the component auditor

- possesses an understanding of the auditing and other standards applicable to the group audit, such as U.S. GAAS, that is sufficient to fulfill the component auditor's responsibilities.
- possesses the special skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies) necessary to perform the work on the financial information of the particular component.
- when relevant, possesses an understanding of the applicable financial reporting framework that is sufficient to fulfill the component auditor's responsibilities in the

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[23]ET section 0.200.020, *Application of the AICPA Code*, of the AICPA Code of Professional Conduct explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA Code of Professional Conduct, provided that component auditors that are not subject to the AICPA Code are in compliance with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Footnote revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

group audit (instructions issued by group management to components often describe the characteristics of the applicable financial reporting framework).

Application of the Group Engagement Team's Understanding of a Component Auditor (Ref: par. .23)

.A49 The group engagement team cannot overcome the fact that a component auditor is not independent by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component or by making reference in the auditor's report on the group financial statements to the audit of the component auditor.

.A50 However, the group engagement team may be able to overcome less than serious concerns about a component auditor's professional competency (for example, lack of industry-specific knowledge) or the fact that a component auditor does not operate in an environment that actively oversees auditors by being involved in the work of that component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.

.A51 When law or regulation prohibits access to relevant parts of the audit documentation of a component auditor, the group engagement team may request the component auditor to overcome this by preparing a memorandum that covers the relevant information.

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements (Ref: par. .24)

.A52 In group audits involving two or more component auditors, the decision to make reference to the audit of a component auditor is made individually for each component auditor, regardless of the decision whether to refer to any other component auditor. The auditor of the group financial statements may make reference to any, all, or none of the component auditors. For example, if significant components are audited by a component auditor from a network firm and one component is audited by another firm, the group engagement partner may decide to assume responsibility for the work of the component auditor from the network firm and to make reference to the work of the component auditor from the other firm.

Determining Whether the Audit Was Conducted in Accordance With GAAS (Ref: par. .25a)

.A53 A component auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph .25*a*. When the component auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the component auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph .25*a*, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group engagement team may provide the component auditor with appendix B, *Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards*, that identifies substantive requirements of GAAS that are not requirements in the ISAs. The component auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the component auditor required by paragraph .42 may address whether the audit of the component auditor met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the component auditor, may decide to make reference to the audit of that component auditor in the auditor's report on the group financial statements. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .26)

.A54 When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group engagement team is required by paragraph .37 to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the auditor of the group financial statements assumes responsibility for, and, thus, is involved in, the work of the component auditor. In rare circumstances, however, the group engagement partner may conclude that the group engagement team can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A55 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A56 Additional considerations in determining whether it may be appropriate to make reference to the audit of a component auditor in the auditor's report on the group financial statements when the component prepares financial statements using a different financial reporting framework than that used by the group include the

- effectiveness of groupwide controls and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group engagement team's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group engagement team's knowledge of the financial reporting framework used to prepare the component financial statements.
- group engagement team's ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Considerations for Governmental Entities

.A57 When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs .26 and .28*c* are not relevant. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Making Reference in the Auditor's Report (Ref: par. .28–.31)

.A58 The disclosure of the magnitude of the portion of the financial statements audited by a component auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a component auditor. When two or more component auditors participate in the audit, the dollar amounts or the percentages covered by the component auditors may be stated in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A59 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a component auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the auditor of the group financial statements is not assuming responsibility for the work of the component auditor, and (2) the source of the audit evidence with respect to those components for which reference to the audit of component auditors is made. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A60 Exhibit A contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A61 If the modified opinion, emphasis-of-matter paragraph, or other-matter paragraph in the component auditor's report does not affect the report on the group financial statements and the component auditor's report is not presented, the auditor of the group financial statements need not make reference to those paragraphs in the auditor's report on the group financial statements. If the component auditor's report is presented, the auditor of the group financial statements may make reference to those paragraphs and their disposition. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A62 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, no reference is made to the component auditor in the report on the group audit because to do so may cause a reader to misinterpret the degree of responsibility being assumed. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality (Ref: par. .32)

.A63 The auditor is required[24]

a. when establishing the overall audit strategy

   i. to determine materiality for the financial statements as a whole.

   ii. to consider whether, in the specific circumstances of the entity, particular classes of transactions, account balances, or disclosures exist for which there is

[24]Paragraphs .10–.11 of section 320.

a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements. In such circumstances, the auditor determines materiality to be applied to those particular classes of transactions, account balances, or disclosures.

b. to determine performance materiality for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks.

In the context of a group audit, materiality is established for both the group financial statements as a whole and the financial information of those components on which the group engagement team will perform, or request a component auditor to perform, an audit or review. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A64 Different materiality may be established for different components. The aggregate of component materiality may exceed group materiality. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A65 Consideration of all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of a component auditor, is necessary when determining component materiality to reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole. Determining component materiality is necessary for the group engagement team to determine the overall group audit plan for the components for which the auditor of the group financial statements is not making reference to the component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A66 When the component is subject to an audit required by law or regulation or performed for another reason, the materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group materiality and, accordingly, be acceptable for purposes of the group audit. In the case of an equity method investment, the investee may be larger than the investor, and the auditor's evidence to support the investor's share of earnings from the investment may consist largely of the audited financial statements of the investee. In such cases, the materiality used by the investee's auditor may be larger than the materiality used by the investor's auditor. When such circumstances exist, the group engagement team may take into consideration matters such as the group's ownership percentage and its share of the investee's profits and losses when determining whether the component materiality used by the investee's auditor is appropriate for purposes of the audit of the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A67 A threshold for misstatements is determined in addition to component materiality. Misstatements identified in the financial information of the component that are above the threshold for misstatements of the group are communicated to the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Responding to Assessed Risks (Ref: par. .33)

.A68 In an audit of group financial statements, appropriate responses to assessed risks of material misstatement for some or all classes of transactions or account balances may be implemented at the group level, without the involvement of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Consolidation Process

Consolidation Adjustments and Reclassifications (Ref: par. .36)

.A69 The consolidation process may require adjustments to amounts reported in the group financial statements that do not pass through the usual transaction processing systems and may not be subject to the same internal controls to which other financial information is subject. The group engagement team's evaluation of the appropriateness, completeness, and accuracy of the adjustments may include the following:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them
- Determining whether significant adjustments have been correctly calculated, processed, and authorized by group management and, when applicable, by component management
- Determining whether significant adjustments are properly supported and sufficiently documented
- Checking the reconciliation and elimination of intragroup account balances, transactions, and unrealized profits or losses
- Communicating with the component auditor, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (Ref: par. .40)

.A70 When the auditor's report on the group financial statements will make reference to the audit of a component auditor, procedures designed to identify subsequent events between the date of the component auditor's report and the date of the auditor's report on the group financial statements may include

- obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified.

- requesting the component auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements.
- requesting written representation from component management regarding subsequent events.
- reading available interim financial information of the component and making inquiries of group management.
- reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date.
- reading the subsequent year's capital and operating budgets.
- inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events.
- considering the implications for the auditor's report on the group financial statements if the group engagement team has been unable to obtain sufficient appropriate audit evidence regarding subsequent events.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. .44–.45)

.A71 If the group engagement team concludes that sufficient appropriate audit evidence on which to base the group audit opinion has not been obtained, the group engagement team may request a component auditor to perform additional procedures. Alternatively, the group engagement team may perform its own procedures on the financial information of the component. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A72 The group engagement partner's evaluation of the aggregate effect of any misstatements (either identified by the group engagement team or communicated by component auditors) allows the group engagement partner to determine whether the group financial statements as a whole are materially misstated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management (Ref: par. .46–.48)

.A73 Section 240, *Consideration of Fraud in a Financial Statement Audit*, contains requirements and guidance on communication of fraud to management and, when management may be involved in the fraud, those charged with governance.[25] [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A74 Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation
- Plans for abandonment of material operating assets
- Subsequent events
- Significant legal agreements

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group (Ref: par. .49)

.A75 The matters the group engagement team communicates to those charged with governance of the group may include those brought to the attention of the group engagement team by component auditors that the group engagement team judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group takes place at various times during the group audit. For example, the matters referred to in paragraph .49*a–b* may be communicated after the group engagement team has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph .49*c* may be communicated at the end of the audit, and the matters referred to in paragraph .49*d–e* may be communicated when they occur. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (Ref: par. .51)

.A76 Component materiality for those components whose financial information will be audited or reviewed as part of the group audit in accordance with paragraphs .53, .54*a*, and .56, is communicated to the component auditor and is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A77 In the case of an audit of the financial information of a component, section 320, *Materiality in Planning and Performing an Audit*, requires the component auditor (or group engagement team) to determine performance materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks.[26] This is necessary to reduce the risk that the aggregate of detected and undetected misstatements in the financial information of the component exceeds component materiality. In practice, the group engagement team may

[25] Paragraphs .39–.41 of section 240.

[26] Paragraph .11 of section 320.

set component materiality at the level of performance materiality for the component. When this is the case, the component auditor uses component materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks, as well as for evaluating whether detected misstatements are material individually or in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Determining the Type of Work to Be Performed on the Financial Information of Components

Significant Components (Ref: par. .53–.54)

.A78 Adapting an audit of the financial information of a significant component to meet the specific needs of the group engagement team may include requesting the component auditor to

- perform an audit, using component materiality, in accordance with GAAS, with the exception of performing audit procedures on, for example, tax accounts or litigation, claims, and assessments because those procedures are performed at the group level.
- communicate the results of the audit in a form that is responsive to the needs of the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A79 The group engagement team's determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by the following:

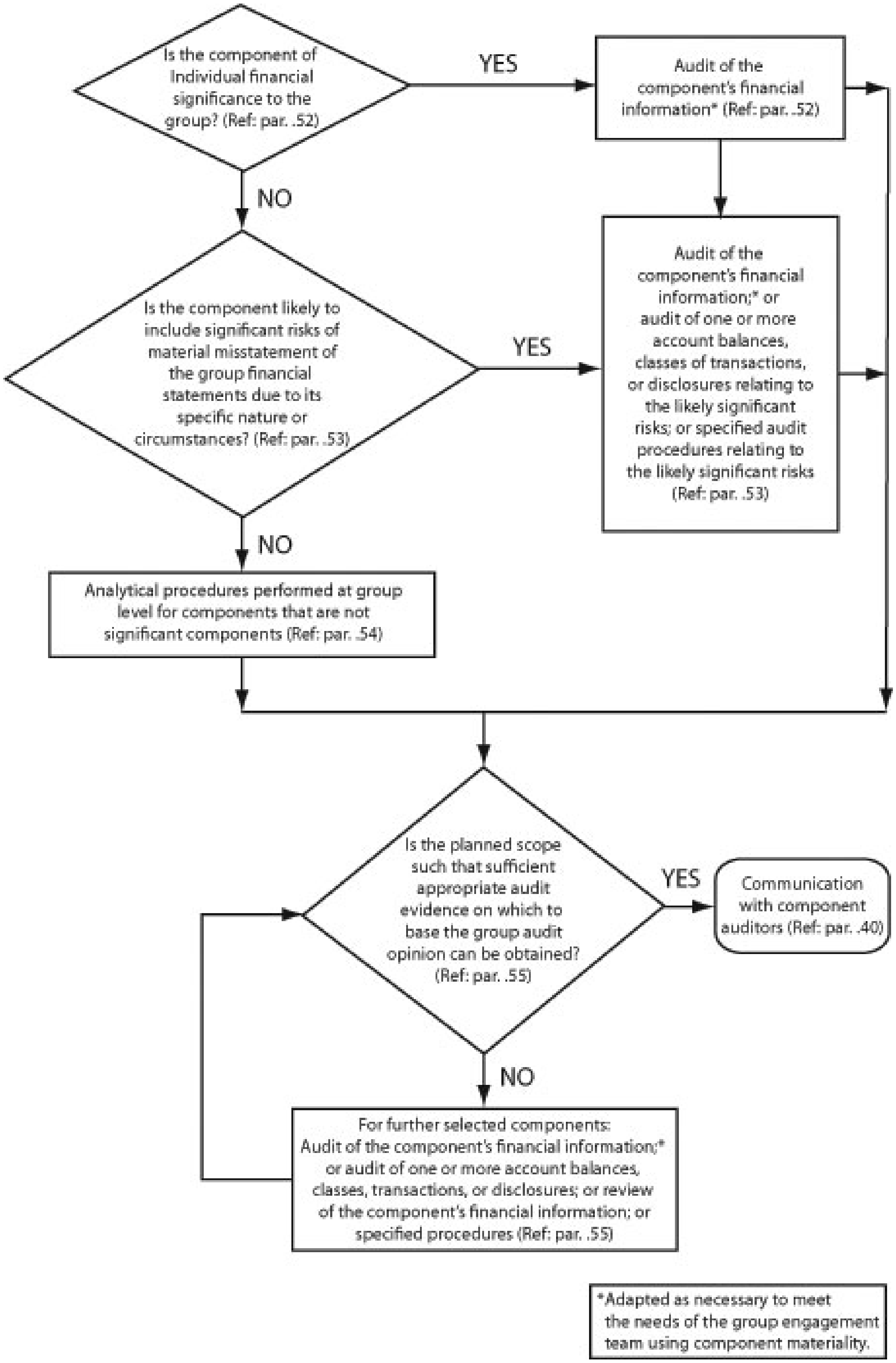
a. The significance of the component

b. The identified significant risks of material misstatement of the group financial statements

c. The group engagement team's evaluation of the design of group-wide controls and the determination of whether they have been implemented

d. The group engagement team's understanding of the component auditor

The following diagram shows how the significance of the component affects the group engagement team's determination of the type of work to be performed on the financial information of the component.



[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A80 The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions, or disclosures affected by the likely significant risks. When this is the case, the group engagement team may decide to perform or request a component auditor to perform an audit, adapted as necessary to meet the needs of the group engagement team, of only those account balances, classes of transactions, or disclosures. For example, in the situation described in paragraph .A7, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions, and disclosures affected by the foreign exchange trading of that component. When the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions, or disclosures, the communication of the group engagement team (see paragraph .41) takes account of the fact that many financial statement items are interrelated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A81 The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements. For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform or request a component auditor to perform specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory but that is not otherwise significant. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components (Ref: par. .55–.56)

.A82 Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that no significant risks of material misstatement exist of the aggregated financial information of components that are not significant components. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A83 The group engagement team's decision about how many components to select in accordance with paragraph .56, which components to select, and the type of work to be performed on the financial information of the individual components selected may be affected by factors, such as the following:

- The extent of audit evidence expected to be obtained on the financial information of the significant components
- Whether the component has been newly formed or acquired
- Whether significant changes have taken place in the component
- Whether the internal audit function has performed work at the component and any effect of that work on the group audit
- Whether the components apply common systems and processes
- The operating effectiveness of group-wide controls

- Abnormal fluctuations identified by analytical procedures performed at group level
- The individual financial significance of, or the risk posed by, the component in comparison with other components within this category
- Whether the component is subject to an audit required by law or regulation or performed for another reason

Including an element of unpredictability in selecting components in this category may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A84 An audit of a component that is not a significant component may have already been performed. Once the group engagement team decides to use that work to provide audit evidence for the group audit, the provisions of this section apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A85 A review of the financial information of a component may be performed in accordance with Statements on Standards for Accounting and Review Services, adapted as necessary in the circumstances. A review is designed to obtain only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The group engagement team also may specify additional procedures to supplement this work. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A86 As explained in paragraph .A19, a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence on which to base the group audit opinion by determining the type of work to be performed on the financial information of the components, in accordance with paragraph .56. It is unlikely that the group engagement team will obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team or a component auditor only tests group-wide controls and performs analytical procedures on the financial information of the components. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Involvement in the Work Performed by Component Auditors (Ref: par. .57–.58)

.A87 Factors that may affect the group engagement team's involvement in the work of a component auditor include the following:

a. The significance of the component
b. The identified significant risks of material misstatement of the group financial statements
c. The group engagement team's understanding of the component auditor

In the case of a significant component or identified significant risks, the group engagement team performs the procedures described in paragraphs .57–.58. In the case of a component that is not a significant component, the nature, timing, and extent of the group engagement team's involvement in the work of the component auditor will vary based on the group engagement team's understanding of that component auditor. The fact that the component is not a significant component becomes secondary. For example, even though a component is not considered a significant component, the group engagement team, nevertheless, may decide to be involved in the component auditor's risk assessment because it has concerns (although less than serious concerns) about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the component auditor does not operate in an environment that actively oversees auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A88 Forms of involvement in the work of a component auditor other than those described in paragraphs .43 and .57–.58 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

- Meeting with component management or the component auditor to obtain an understanding of the component and its environment.
- Reviewing the component auditor's overall audit strategy and audit plan.
- Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditor or by the group engagement team.
- Designing and performing further audit procedures. These may be designed and performed with the component auditor or by the group engagement team.
- Participating in the closing and other key meetings between the component auditor and component management.
- Reviewing other relevant parts of the component auditor's audit documentation.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (Ref: par. .60)

.A89 If effective two-way communication does not exist between the group engagement team and component auditors, whose work the auditor of the group financial statements is assuming responsibility for, a risk exists that the group engagement team may not obtain sufficient appropriate audit evidence on which to base the group audit opinion. Clear and timely communication of the group engagement team's requirements forms the basis of effective two-way communication between the group engagement team and a component auditor. This two-way communication also may be initiated by the component auditor regarding matters that may be significant to the component audit such as

- transactions, adjustments, or other matters that have come to the group engagement team's attention that it believes require adjustment to or disclosure in the financial statements of the component being audited by the component auditor.
- any relevant limitation on the scope of the audit performed by the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A90 The group engagement team's requirements often are communicated in a letter of instruction. Appendix C, "Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction," contains guidance on required and additional matters that may be included in such a letter of instruction. A component auditor's communication with the group engagement team often takes the form of a memorandum or report of work performed. Communication between the group engagement team and a component auditor, however, may not necessarily be in writing. For example, the group engagement team may visit the component auditor to discuss identified significant risks or review relevant parts of the component auditor's audit documentation. Nevertheless, the documentation requirements of this section and other AU-C sections apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A91 In cooperating with the group engagement team, a component auditor, for example, would provide the group engagement team with access to relevant audit documentation, if not prohibited by law or regulation. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A92 When a member of the group engagement team is also a component auditor, the objective for the group engagement team to communicate clearly with the component auditor often can be achieved by means other than specific written communication. For example

- access by the component auditor to the overall audit strategy and audit plan may be sufficient to communicate the group engagement team's requirements set out in paragraph .41.
- a review of the component auditor's audit documentation by the group engagement team may be sufficient to communicate matters relevant to the group engagement team's conclusion set out in paragraph .42.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Reviewing a Component Auditor's Audit Documentation (Ref: par. .62)

.A93 The parts of the audit documentation of a component auditor that will be relevant to the group audit may vary depending on the circumstances. Often, the focus is on audit documentation that is relevant to the significant risks of material misstatement of the group financial statements. The extent of the review may be affected by the fact that a component auditor's audit documentation has been subjected to the review procedures of the component auditor's firm. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Appendix A — Understanding the Group, Its Components, and Their Environments — Examples of Matters About Which the Group Engagement Team Obtains an Understanding (Ref: par. .A31)

.A94 The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement, and the list of examples is not necessarily complete.

Group-Wide Controls

Group-wide controls may include a combination of the following:

- Regular meetings between group and component management to discuss business developments and review performance
- Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets and take appropriate action
- Group management's risk assessment process (that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements)
- Monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses at group level
- A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components
- A central IT system controlled by the same general IT controls for all or part of the group
- Controls within an IT system that are common for all or some components
- Controls within the group's process to monitor the system of internal control, including activities of the internal audit function and self-assessment programs
- Consistent policies and procedures, including a group financial reporting procedures manual
- Group-wide programs, such as codes of conduct and fraud prevention programs
- Arrangements for assigning authority and responsibility to component management

The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. Section 610, *Using the Work of Internal Auditors*, addresses the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a systematic and disciplined approach when the group engagement team expects to use the function's work.[1]

Consolidation Process

The group engagement team's understanding of the consolidation process may include matters such as the following:

- Matters relating to the applicable financial reporting framework, such as the following:
  - — The extent to which component management has an understanding of the applicable financial reporting framework
  - — The process for identifying and accounting for components, in accordance with the applicable financial reporting framework
  - — The process for identifying reportable segments for segment reporting, in accordance with the applicable financial reporting framework
  - — The process for identifying related party relationships and related party transactions for reporting, in accordance with the applicable financial reporting framework
  - — The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework
  - — The procedures for dealing with components with financial year-ends different from the group's year-end
- Matters relating to the consolidation process, such as the following:
  - — Group management's process for obtaining an understanding of the accounting policies used by components and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the components for the group financial statements and that differences in accounting policies are identified and adjusted, when required, in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the components use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
  - — Group management's process for ensuring complete, accurate, and timely financial reporting by the components for the consolidation.

[1]Paragraphs .14–.15 of section 610, *Using the Work of Internal Auditors*. [Footnote amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

- — The process for translating the financial information of foreign components into the currency of the group financial statements.
- — How IT is organized for the consolidation, including the manual and automated stages of the process and the manual and programmed controls in place at various stages of the consolidation process.
- — Group management's process for obtaining information on subsequent events.

- Matters relating to consolidation adjustments, such as the following:
  - — The process for recording consolidation adjustments, including the preparation, authorization, and processing of related journal entries and the experience of personnel responsible for the consolidation
  - — The consolidation adjustments required by the applicable financial reporting framework
  - — Business purpose for the events and transactions that gave rise to the consolidation adjustments
  - — Frequency, nature, and size of transactions between components
  - — Procedures for monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses
  - — Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework
  - — Arrangements with a controlling interest or noncontrolling interest regarding losses incurred by a component (for example, an obligation of the noncontrolling interest to compensate such losses)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 135. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Appendix B — Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements (Ref: par. .A38)

.A95 The examples provided cover a broad range of conditions or events; however, not all conditions or events are relevant to every group audit engagement, and the following list of examples is not necessarily complete:

- A complex group structure, especially when there are frequent acquisitions, disposals, or reorganizations
- Poor corporate governance structures, including decision-making processes, that are not transparent
- Nonexistent or ineffective group-wide controls, including inadequate group management information on monitoring of components' operations and their results
- Components operating in foreign jurisdictions that may be exposed to factors, such as unusual government intervention in areas such as trade and fiscal policy, restrictions on currency and dividend movements, and fluctuations in exchange rates
- Business activities of components that involve high risk, such as long-term contracts or trading in innovative or complex financial instruments
- Uncertainties regarding which components' financial information requires incorporation in the group financial statements, in accordance with the applicable financial reporting framework (for example, whether any special purpose entities or nontrading entities exist and require incorporation)
- Unusual related party relationships and transactions
- Prior occurrences of intragroup account balances that did not balance or reconcile on consolidation
- The existence of complex transactions that are accounted for in more than one component
- Components' application of accounting policies that differ from those applied to the group financial statements
- Components with different financial year-ends, which may be utilized to manipulate the timing of transactions
- Prior occurrences of unauthorized or incomplete consolidation adjustments
- Aggressive tax planning within the group or large cash transactions with entities in tax havens
- Frequent changes of auditors engaged to audit the financial statements of components

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Appendix C — Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction (Ref: par. .A90)

.A96 The following matters are relevant to the planning of the work of a component auditor:

[*Required matters are italicized.*]

- *A request for the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to confirm that the component auditor will cooperate with the group engagement team*
- The timetable for completing the audit
- Dates of planned visits by group management and the group engagement team and dates of planned meetings with component management and the component auditor
- A list of key contacts
- *The work to be performed by the component auditor, the use to be made of that work,* and arrangements for coordinating efforts at the initial stage of and during the audit, including the group engagement team's planned involvement in the work of the component auditor
- *The ethical requirements that are relevant to the group audit and, in particular, the independence requirements*
- *In the case of an audit or review of the financial information of the component, component materiality*
- *In the case of an audit or review of, or specified audit procedures performed on, the financial information of the component, the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements*
- *A list of related parties prepared by group management and any other related parties of which the group engagement team is aware and a request that the component auditor communicates on a timely basis to the group engagement team related parties not previously identified by group management or the group engagement team*
- Work to be performed on intragroup account balances, transactions, and unrealized profits or losses
- Guidance on other statutory reporting responsibilities (for example, reporting on group management's assertion on the effectiveness of internal control)
- When a time lag between completion of the work on the financial information of the components and the group engagement team's conclusion on the group financial statements is likely, specific instructions for a subsequent events review

The following matters are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of controls of a processing system that is common for all or some components and tests of controls to be performed by the component auditor
- *Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor and a request that the component auditor communicates on a timely basis any other significant risks of material misstatement of the group financial statements, due to fraud or error, identified in the component and the component auditor's response to such risks*
- The findings of the internal audit function, based on work performed on controls at or relevant to components
- A request for timely communication of audit evidence obtained from performing work on the financial information of the components that contradicts the audit evidence on which the group engagement team originally based the risk assessment performed at group level
- A request for a written representation on component management's compliance with the applicable financial reporting framework or a statement that differences between the accounting policies applied to the financial information of the component and those applied to the group financial statements have been disclosed
- Matters to be documented by the component auditor

Other information, such as the following:

- A request that the following be reported to the group engagement team on a timely basis:
  - Significant accounting, financial reporting, and auditing matters, including accounting estimates and related judgments
  - Matters relating to the going concern status of the component
  - Matters relating to litigation and claims
  - Material weaknesses in controls that have come to the attention of the component auditor during the performance of the work on the financial information of the component and information that indicates the existence of fraud
- A request that the group engagement team be notified of any significant or unusual events as early as possible
- A request that the matters listed in paragraph .49 be communicated to the group engagement team when the work on the financial information of the component is completed

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Exhibit A — Illustrations of Auditor's Reports on Group Financial Statements

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Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion (Ref: par. .A27)

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards (Ref: par. .A60)

Illustration 3 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework Than That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS (Ref: par. .A60)

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS (Ref: par. .A60)

Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Qualified Opinion

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[1]The subtitle "Report on the Audit of Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at $_______ and $_______ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of $_______ and $_______, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

_Other Information [_or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"_]_

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[2] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

[1]The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [*or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"*]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[2] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3— A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

[1]The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose

of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[2] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of,

[1]The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

[2] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Exhibit B — Illustrative Component Auditor's Confirmation Letter (Ref: par. .A44)

.A98 The following is not intended to be a standard letter. Confirmations may vary from one component auditor to another and from one period to the next. In this example, confirmations expected only when the auditor of the group financial statements is assuming responsibility have been italicized.

Confirmations often are obtained before work on the financial information of the component commences.

[*Component Auditor Letterhead*]

[*Date*]

[*To Audit Firm*]

This letter is provided in connection with your audit of the group financial statements of [*name of parent*] as of and for the year ended [*date*] for the purpose of expressing an opinion on whether the group financial statements present fairly, in all material respects, the financial position of the group as of [*date*] and of the results of its operations and its cash flows for the year then ended in accordance with [*indicate applicable financial reporting framework*].

We acknowledge receipt of your instructions dated [*date*], requesting us to perform the specified work on the financial information of [*name of component*] as of and for the year ended [*date*].

We confirm that:

1. *We will be able to comply with the instructions. / We advise you that we will not be able to comply with the following instructions [*specify instructions*] for the following reasons [*specify reasons*].*
2. *The instructions are clear, and we understand them. / We would appreciate it if you could clarify the following instructions [*specify instructions*].*
3. *We will cooperate with you and provide you with access to relevant audit documentation.*

We acknowledge that:

1. The financial information of [*name of component*] will be included in the group financial statements of [*name of parent*].
2. *You may consider it necessary to be further involved in the work you have requested us to perform on the financial information of [*name of component*] as of and for the year ended [*date*].*
3. *You intend to evaluate and, if considered appropriate, use our work for the audit of the group financial statements of [*name of parent*].*

In connection with the work that we will perform on the financial information of [*name of component*], a [*describe component, e.g., wholly-owned subsidiary, subsidiary, joint venture, investee accounted for by the equity or cost methods of accounting*] of [*name of parent*], we confirm the following:

1. We have an understanding of [*indicate relevant ethical requirements*] that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will comply therewith. In particular, and with respect to [*name of parent*] and the

other components in the group, we are independent within the meaning of [*indicate relevant ethical requirements*] and comply with the applicable requirements of [*refer to rules*] promulgated by [*name of regulatory agency*].

2. We have an understanding of auditing standards generally accepted in the United States of America and [*indicate other auditing standards applicable to the audit of the group financial statements, such as* Government Auditing Standards] that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will conduct our work on the financial information of [*name of component*] as of and for the year ended [*date*] in accordance with those standards.

3. We possess the special skills (e.g., industry specific knowledge) necessary to perform the work on the financial information of the particular component.

4. We have an understanding of [*indicate applicable financial reporting framework or group financial reporting procedures manual*] that is sufficient to fulfill our responsibilities in the audit of the group financial statements.

We will inform you of any changes in the above representations during the course of our work on the financial information of [*name of component*].

[*Auditor's signature*]

Illustration of Potential Component Auditor Representations in Governmental Entities and Not-for-Profit Organizations

5. We have an understanding of relevant laws and regulations that may have a direct and material effect on the financial statements of [*name of component*]. In particular, we have an understanding of [*indicate relevant laws and regulations*].

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Exhibit C — Sources of Information (Ref: par. .A47)

.A99 The AICPA Professional Ethics Team can respond to inquiries about whether individuals are members of the AICPA and whether complaints against members have been adjudicated by the Joint Trial Board. The team cannot respond to inquiries about public accounting firms or provide information about letters of required corrective action issued by the team or pending disciplinary proceedings or investigations. The AICPA Peer Review Program staff or the applicable state CPA society administering entity can respond to inquiries about whether specific public accounting firms are enrolled in the AICPA Peer Review Program and the date of acceptance and the period covered by the firm's most recently accepted peer review. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

AU-C Section 9600A

Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors): Auditing Interpretations of Section 600A

New GASB Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

Interpretation No. 1, "Auditor of Participating Employer in a Governmental Pension Plan," (paragraphs .01–.02) is intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

1. Auditor of Participating Employer in a Governmental Pension Plan

.01 *Question*—Many governmental entities (employers) provide pension benefits to their employees through governmental pension plans. In order to report pension amounts in accordance with GASB Statement No. 68, employers obtain certain information (for example, net pension liability) from the governmental pension plan. In this circumstance, is the governmental pension plan considered a component of the employer for purposes of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*?

.02 *Interpretation*—No. In this circumstance, a governmental pension plan is not a component of the employer for purposes of section 600A. Accordingly, it would not be appropriate for an employer auditor to make reference to the audit report of the governmental pension plan auditor.

[Issue Date: April 2014.]

AU-C Section 610

Using the Work of Internal Auditors

Source: SAS No. 128; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2014.

Note

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the external auditor's responsibilities if using the work of internal auditors. Using the work of internal auditors includes (*a*) using the work of the internal audit function in obtaining audit evidence and (*b*) using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor.

.02 This section does not apply if the entity does not have an internal audit function. (Ref: par. .A1–.A2)

.03 If the entity has an internal audit function, the requirements in this section relating to using the work of the internal audit function in obtaining audit evidence do not apply if

a. the responsibilities and activities of the function are not relevant to the audit, or

b. based on the external auditor's preliminary understanding of the function obtained as a result of procedures performed under section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the external auditor does not expect to use the work of the function in obtaining audit evidence.

Nothing in this section requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains the external auditor's decision to establish the overall audit strategy.

.04 Furthermore, the requirements in this section relating to using internal auditors to provide direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

Relationship Between Section 315 and This Section

.05 Many entities establish internal audit functions as part of their internal control and governance structures. The objectives and scope of an internal audit function, the nature of its responsibilities, and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and identification and assessment of risks of material misstatement. SAS No. 145[1] also explains how effective communication between the internal and external auditors creates an environment in which the external auditor can be informed by the internal auditor of significant matters that may affect the external auditor's work. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.06 The external auditor may be able to use the work of the internal audit function in obtaining audit evidence in a constructive and complementary manner depending on

- the level of competency of the internal audit function,
- whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, and
- whether the function applies a systematic and disciplined approach, including quality control.

This section addresses the external auditor's responsibilities when, based on the external auditor's understanding of the internal audit function obtained as a result of procedures performed under section 315, the external auditor expects to use the work of the internal audit function in obtaining audit evidence (see paragraphs .13–.24 of this section). Such use of that work modifies the nature or timing, or reduces the extent, of audit procedures to be performed directly by the external auditor.

[1]Paragraph .A120 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

.07 This section also addresses the external auditor's responsibilities if the external auditor is considering using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor (see paragraphs .25–.32).

.08 There may be individuals in an entity that perform procedures similar to those performed by an internal audit function. However, unless performed by an objective and competent function that applies a systematic and disciplined approach, including quality control, such procedures would be considered control activities, and obtaining evidence regarding the effectiveness of such controls would be part of the external auditor's responses to assessed risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

The External Auditor's Responsibility for the Audit

.09 The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function in obtaining audit evidence or use of internal auditors to provide direct assistance on the engagement. Although the function may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.[2] This section, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the internal audit function or internal auditors providing direct assistance is adequate for the purposes of the audit. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2014.

Objectives

.11 The objectives of the external auditor, when the entity has an internal audit function and the external auditor expects to use the work of internal auditors to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, are as follows:

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[2]Paragraph .15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

a. To determine whether to use the work of the internal audit function in obtaining audit evidence or to use internal auditors to provide direct assistance, and if so, in which areas and to what extent

b. If using the work of the internal audit function in obtaining audit evidence, to determine whether that work is adequate for purposes of the audit

c. If using internal auditors to provide direct assistance, to appropriately direct, supervise, and review their work

Definitions

.12 For purposes of generally accepted auditing standards, the following terms have the meaning attributed as follows:

Direct assistance. The use of internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor.

Internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes. (Ref: par. .A1–.A4)

Requirements

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

Evaluating the Internal Audit Function

.13 The external auditor should determine whether the work of the internal audit function can be used in obtaining audit evidence by evaluating

a. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; (Ref: par. .A5–.A11)

b. the level of competence of the internal audit function; and (Ref: par. .A5–.A9)

c. the application by the internal audit function of a systematic and disciplined approach, including quality control. (Ref: par. .A12–.A14)

.14 The external auditor should not use the work of the internal audit function in obtaining audit evidence if the external auditor determines that

a. the function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;

b. the function lacks sufficient competence; or

c. the function does not apply a systematic and disciplined approach, including quality control. (Ref: par. .A15–.A17)

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

.15 As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor should consider the nature, timing, and extent of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: par. .A18–.A23)

.16 The external auditor should make all significant judgments in the audit engagement, including when using the work of the internal audit function in obtaining audit evidence. (Ref: par. .A18)

.17 To prevent undue use of the internal audit function in obtaining audit evidence, the external auditor should plan to use less of the work of the function and perform more of the work directly: (Ref: par. .A19–.A24)

a. The more judgment is involved in
    i. planning and performing relevant audit procedures or
    ii. evaluating the audit evidence obtained (Ref: par. .A24)
b. the higher the assessed risk of material misstatement at the assertion level, with special consideration given to significant risks; (Ref: par. .A25–.A27)
c. the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
d. the lower the level of competence of the internal audit function.

.18 The external auditor should also evaluate whether, in aggregate, using the work of the internal audit function in obtaining audit evidence to the extent planned, together with any planned use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A18–.A27 and .A44)

Communicating With Those Charged With Governance

.19 In communicating an overview of the planned scope and timing of the audit to those charged with governance in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*,[3] the external auditor should communicate how the external auditor has planned to use the work of the internal audit function in obtaining audit evidence. (Ref: par. .A28)

[3]Paragraph .11 of section 260, *The Auditor's Communication With Those Charged With Governance*.

Using the Work of the Internal Audit Function in Obtaining Audit Evidence

.20 If the external auditor plans to use the work of the internal audit function in obtaining audit evidence, the external auditor should discuss the planned use of the work with the function as a basis for coordinating their respective activities. (Ref: par. .A29–.A32)

.21 The external auditor should read the reports of the internal audit function, which relate to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures the internal audit function performed and the related findings.

.22 The external auditor should perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether

a. the work of the function was properly planned, performed, supervised, reviewed, and documented;

b. sufficient appropriate evidence was obtained to enable the function to draw reasonable conclusions; and

c. conclusions reached are appropriate in the circumstances, and the reports prepared by the function are consistent with the results of the work performed. (Ref: par. .A33–.A36)

.23 The nature and extent of the external auditor's audit procedures should be responsive to the external auditor's evaluation of

a. the amount of judgment involved in

   i. planning and performing relevant audit procedures and

   ii. evaluating the audit evidence obtained;

b. the assessed risk of material misstatement;

c. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and

d. the level of competence of the function. (Ref: par. .A33–.A35) (see paragraphs .16–.17)

The external auditor should also reperform some of the body of work of the internal audit function that the external auditor intends to use in obtaining audit evidence. (Ref: par. .A36)

.24 Before the conclusion of the audit, the external auditor should evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph .13 and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs .16–.18 remain appropriate.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit

.25 If the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor should evaluate the existence and significance of threats to the objectivity of the internal auditors who will be providing direct assistance, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors who will be providing such assistance. (Ref: par. .A37–.A41)

.26 The external auditor should not use an internal auditor to provide direct assistance if

a. the internal auditor lacks the necessary objectivity to perform the proposed work, or

b. the internal auditor lacks the necessary competence to perform the proposed work. (Ref: par. .A37–.A41)

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance

.27 In determining the nature and extent of work that may be assigned to internal auditors providing direct assistance and the nature, timing, and extent of direction, supervision, and review that is appropriate in the circumstances, the external auditor should consider

a. the external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity, the effectiveness of the safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors who will be providing such assistance;

b. the assessed risk of material misstatement; and

c. the amount of judgment involved in

    i. planning and performing relevant audit procedures and

    ii. evaluating the audit evidence obtained. (Ref: par. .A42–.A43)

Communicating With Those Charged With Governance

.28 In communicating an overview of the planned scope and timing of the audit with those charged with governance in accordance with section 260,[4] the external auditor should communicate how the external auditor plans to use internal auditors to provide direct assistance.

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[4]See footnote 3.

Using Internal Auditors to Provide Direct Assistance

.29 The external auditor should evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with any planned use of the work of the internal audit function in obtaining audit evidence, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A44)

.30 Prior to using internal auditors to provide direct assistance, the external auditor should obtain written acknowledgment from management or those charged with governance, as appropriate, that internal auditors providing direct assistance to the external auditor will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor. (Ref: par. .A45)

.31 The external auditor should direct, supervise, and review the work performed by internal auditors on the engagement in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. In so doing

a. the nature, timing, and extent of direction, supervision, and review should be responsive to the outcome of the evaluation of the factors in paragraph .27 of this section;

b. the external auditor should instruct the internal auditors to bring accounting and auditing issues identified during the audit to the attention of the external auditor; and

c. the review procedures should include the external auditor testing some of the work performed by the internal auditors. (Ref: par. .A46–.A47)

.32 When directing, supervising, and reviewing the work performed by internal auditors, the external auditor should remain alert for indications that the external auditor's evaluations in paragraphs .25 and .29 are no longer appropriate.

Documentation

.33 If the external auditor uses the work of the internal audit function in obtaining audit evidence, the external auditor should include the following in the audit documentation:[5]

a. The results of the evaluation of

   i. the function's organizational status and relevant policies and procedures to adequately support the objectivity of the internal auditors;

   ii. the level of competence of the function; and

[5]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

iii. the application by the function of a systematic and disciplined approach, including quality control

b. The nature and extent of the work used (including the period covered by, and the results of, such work) and the basis for that decision

c. The audit procedures performed by the external auditor to evaluate the adequacy of the work used, including the procedures performed by the external auditor to reperform some of the body of work of the internal audit function in obtaining audit evidence

.34 If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor should include the following in the audit documentation:

a. The evaluation of the existence and significance of threats to the objectivity of the internal auditors, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors used to provide direct assistance

b. The basis for the decision regarding the nature and extent of the work performed by the internal auditors

c. The nature and extent of the external auditor's review of the internal auditors' work (including the testing, by the external auditor, of some of the work performed by the internal auditors) in accordance with section 230, *Audit Documentation*

d. The working papers prepared by the internal auditors who provided direct assistance on the audit engagement

.35 If the external auditor uses either the work of the internal audit function in obtaining audit evidence or internal auditors to provide direct assistance, or both, the external auditor should include in the audit documentation the external auditor's evaluation of (see paragraphs .18 and .29) whether, either individually or in aggregate as applicable, using the work of the internal audit function in obtaining audit evidence and use of internal auditors to provide direct assistance resulted in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

Application and Other Explanatory Material

Definition of *Internal Audit Function* (Ref: par. .02 and .12)

.A1 The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes, such as the following:

Activities Relating to Governance Process

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization, and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Activities Relating to Risk Management Process

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

Activities Relating to Internal Control Process

- *Evaluation of internal control*. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation, and operating effectiveness of internal control, including those controls that are relevant to the audit.
- *Examination of financial and operating information*. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify, and report financial and operating information and to make specific inquiry into individual items, including detailed testing of transactions, balances, and procedures.
- *Review of operating activities*. The internal audit function may be assigned to review the economy, efficiency, and effectiveness of operating activities, including nonfinancial activities of an entity.
- *Review of compliance with laws and regulations*. The internal audit function may be assigned to review compliance with laws, regulations, and other external requirements and with management policies and directives and other internal requirements.

Not all the activities discussed in this paragraph need to be present for an internal audit function to be used in the audit of the financial statements. The external auditor may be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor in obtaining audit evidence if the nature of the internal audit function's responsibilities and assurance activities is related to the entity's financial reporting, as further discussed in section 315A.[6]

.A2 Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function nor whether it is performed by the entity or a third-party service provider are

[6]Paragraph .A117 of section 315A.

sole determinants of whether the external auditor can use the work of internal auditors. Rather, it is the nature of the activities, the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, competence of the internal auditors, and systematic and disciplined approach of the function that are relevant. References in this section to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

.A3 However, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this section, although they may perform controls that can be tested in accordance with section 330.[7] For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A4 Although the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or both of the following ways:

- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud. In this regard, section 315A[8] requires the external auditor to obtain an understanding of the nature of the internal audit function's responsibilities, its status within the organization, and the activities performed, or to be performed, and make inquiries of appropriate individuals within the internal audit function (if the entity has such a function).
- The external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function that is relevant to the period being audited to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor (that is, the external auditor can use the work of the internal audit function in partial substitution for audit evidence to be obtained directly by the external auditor) (see paragraphs .13–.24 of this section).

In addition, the external auditor may use internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor (referred to as *direct assistance* in this section) (see paragraphs .25–.32 of this section).

[7]Paragraph .10 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[8]Paragraphs .06*a* and .24 of section 315A.

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

Evaluating the Internal Audit Function

Objectivity and Competence (Ref: par. .13a–b)

.A5 The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used in obtaining audit evidence and the nature and extent to which the work of the internal audit function can be used in the circumstances.

.A6 The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors and the level of competence of the function are particularly important in determining whether to use the work of the internal audit function in obtaining audit evidence and, if so, the nature and extent of the use of the work of the function that is appropriate in the circumstances.

.A7 *Objectivity* refers to the ability to perform tasks without allowing bias, conflict of interest, or undue influence of others to override professional judgments. Factors that may affect the external auditor's evaluation of objectivity include the following:

- Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest, or undue influence of others to override professional judgments (for example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance)
- Whether the internal audit function is free of any conflicting responsibilities (for example, having managerial or operational duties or responsibilities that are outside of the internal audit function)
- Whether those charged with governance oversee employment decisions related to the internal audit function (for example, determining the appropriate remuneration policy)
- Whether any constraints or restrictions placed on the internal audit function by management or those charged with governance exist (for example, in communicating the internal audit function's findings to the external auditor)
- Whether the internal auditors are members of relevant professional bodies and their memberships obligate their compliance with relevant professional standards relating to objectivity or whether their internal policies achieve the same objectives

.A8 *Competence* of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and with the appropriate level of quality. Factors that may affect the external auditor's determination about competence include the following:

- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
- Whether established policies for hiring, training, and assigning internal auditors to internal audit engagements exist.
- Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria that may be considered by the external auditor in making the assessment may include, for example, the internal auditors' possession of a relevant professional designation and experience.
- Whether the internal auditors possess the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework and whether the internal audit function possesses the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's financial statements.
- Whether the internal auditors are members of relevant professional bodies or have certifications that oblige them to comply with the relevant professional standards, including continuing professional education requirements.

.A9 Objectivity and competence may be viewed as a continuum. The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function in obtaining audit evidence and make use of it in more areas. However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function. Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors. Additionally, neither a high level of competence nor strong support for the objectivity of the internal auditors compensate for the lack of a systematic and disciplined approach.

Considerations Specific to Governmental Entities (Ref: par. .13a)

.A10 *Generally Accepted Government Auditing Standards* (GAGAS), established by the U.S. Government Accountability Office, addresses the evaluation of the internal audit function in a government environment, including consideration of whether the internal audit function

- reports to senior management, such as a city manager or finance director,
- reports to the governing body,
- is elected, and, thus, is accountable to the citizens, or
- reports to an audit committee, which may comprise the governing body or a subcommittee thereof, members of senior management, appointed citizens, or any combination thereof.

.A11 The GAGAS conceptual framework approach provides auditors a practicable approach to address threats to independence and can be applied to varying circumstances that could potentially create threats to independence. The GAGAS conceptual framework may be useful in evaluating the objectivity of the internal audit function of a governmental entity.

Application of a Systematic and Disciplined Approach, Including Quality Control (Ref: par. .13c)

.A12 The application of a systematic and disciplined approach to planning, performing, supervising, reviewing, and documenting its activities distinguishes the activities of the internal audit function from other monitoring controls that may be performed within the entity. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A13 Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

- The existence, adequacy, and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation, and reporting, the nature and extent of which is commensurate with the nature and size of the internal audit function relative to the complexity of the entity.
- Whether the internal audit function has appropriate quality control policies and procedures (for example, those relating to leadership, human resources, and engagement performance) or quality control requirements in standards set by relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements, such as conducting periodic external quality assessments.

.A14 The external auditor's determination of whether the internal audit function applies a systematic and disciplined approach is intended to address the risk that the external auditor inappropriately uses internal audit-like work performed in an informal, unstructured, or ad hoc manner. However, the level of formality of an acceptable approach may vary depending on the nature and size of the internal audit function relative to the complexity of the entity.

Circumstances in Which Work of the Internal Audit Function Cannot Be Used (Ref: par. .14)

.A15 The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach may indicate that the risks to the quality of the work of the function are too significant and, therefore, it is not appropriate to use any of the work of the function as audit evidence.

.A16 Consideration of the factors in paragraphs .A7–.A8 and .A13, individually and in aggregate, is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors. If the internal audit function reports to management other than in an administrative capacity, this may impair the function's objectivity absent safeguards applied to reduce or eliminate the threat (for example, having direct access and performance accountability to those charged with governance).

.A17 In addition, when the external auditor accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the audit, a self-review threat is created in regards to the external auditor's independence. This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm.

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used (Ref: par. .15–.18)

.A18 Because the external auditor has sole responsibility for the audit opinion expressed, the external auditor is required to make the significant judgments in the audit engagement in accordance with paragraph .16. Significant judgments include, but are not limited to, the following:

- Assessing the risks of material misstatement
- Evaluating the sufficiency of tests performed
- Evaluating the appropriateness of management's use of the going concern assumption and whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- Evaluating significant accounting estimates
- Evaluating the adequacy of disclosures in the financial statements and other matters affecting the external auditor's report

.A19 Once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function that has been performed, or is planned to be performed, is relevant to the overall audit strategy and audit plan that the external auditor has established in accordance with section 300, *Planning an Audit*.

.A20 In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.[9] Further audit procedures comprise tests of controls and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the

[9]Paragraph .06 of section 330.

further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform

- tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function's tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly.
- substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed.

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) and reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures in accordance with the requirements of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

.A21 Other examples of work of the internal audit function that can be used in obtaining audit evidence by the external auditor include the following:

- Tracing transactions through the information system relevant to financial reporting
- Testing of compliance with regulatory requirements

.A22 The external auditor's determination of the planned nature and extent of use of the work of the internal audit function in obtaining audit evidence will be influenced by the external auditor's evaluation of the extent to which the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the level of competence of the internal audit function in paragraph .13. In addition, the amount of judgment needed in planning, performing, and evaluating such work and the assessed risk of material misstatement at the assertion level are inputs to the external auditor's determination. Further, as described in paragraph .14, circumstances exist in which the external auditor cannot use the work of the internal audit function in obtaining audit evidence for purpose of the audit.

.A23 When evaluating whether, in aggregate, using the work of the internal audit function to the extent planned, together with any use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, the external auditor may consider the external auditor's responsibility to address all relevant requirements of this section, as well as the other standards (for example, in accordance with paragraph .16, the external auditor is required to make all significant judgments). It is not anticipated that the external auditor's evaluation of using work of the internal audit function would be based on a quantitative analysis (for example, percentage of hours spent by internal audit personnel in respect of the work being used by the external auditor relative to total engagement hours).

Judgments in Planning and Performing Audit Procedures and Evaluating Results (Ref: par. .17a)

.A24 As the degree of judgment involved in planning and performing the audit procedures or evaluating the audit evidence increases, the need for the external auditor to perform more procedures directly in accordance with paragraph .17 increases.

Assessed Risk of Material Misstatement (Ref: par. .17b)

.A25 For a particular account balance, class of transaction, or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly in accordance with paragraph .17 and, accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as explained in section 200,[10] the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be and, therefore, the external auditor will need to perform more of the work directly.

.A26 As explained in SAS No. 145,[11] significant risks are risks assessed close to the upper end of the spectrum of inherent risk and, therefore, the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgment. In addition, when the risks of material misstatement is other than low, the use of the work of the internal audit function in obtaining audit evidence alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A27 Carrying out procedures in accordance with this section may cause the external auditor to reevaluate the assessment of the risks of material misstatement. Consequently, this may affect the external auditor's determination of whether and how to use the work of the internal audit function in obtaining audit evidence.

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[10]Paragraph .A33 of section 200.

[11]Paragraph .04 of section 315.

Communicating With Those Charged With Governance (Ref: par. .19)

.A28 In accordance with section 260,[12] the external auditor is required to communicate an overview of the planned scope and timing of the audit with those charged with governance. The planned use of the work of the internal audit function in obtaining audit evidence is an integral part of the external auditor's overall audit strategy and, therefore, is relevant to those charged with governance for their understanding of the proposed audit approach.

Using the Work of the Internal Audit Function in Obtaining Audit Evidence

Discussion and Coordination With the Internal Audit Function in Obtaining Audit Evidence (Ref: par. .20)

.A29 In discussing the planned use of the work of the internal audit function in obtaining audit evidence, as a basis for coordinating the respective activities, it may be useful to address the following:

- The timing of such work
- The nature of the work performed
- The extent of audit coverage
- Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) and performance materiality
- Proposed methods of item selection and sample sizes
- Documentation of the work performed
- Review and reporting procedures

.A30 Coordination between the external auditor and the internal audit function is effective when, for example

- discussions take place at appropriate intervals throughout the period.
- the external auditor informs the internal audit function of significant matters that may affect the function.
- the external auditor is advised of, and has access to, relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Although the external auditor is not precluded from using work that the internal audit function has already performed, coordination of activities between the external auditor and

[12] Paragraph .11 of section 260.

internal audit function is likely to be most effective when appropriate interaction occurs before the internal audit function performs the work.

.A31 Section 200[13] addresses the importance of the external auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.

.A32 Communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.[14] The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding any actual, suspected, or alleged fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*.

Procedures to Determine the Adequacy of the Work of the Internal Audit Function (Ref: par. .22–.23)

.A33 The external auditor's audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use provide a basis for evaluating the overall quality of the function's work and the objectivity with which it has been performed.

.A34 The procedures the external auditor may perform to evaluate the quality of the work performed and the conclusions reached by the internal audit function, in addition to reperformance in accordance with paragraph .23, include the following:

- Making inquiries of appropriate individuals within the internal audit function
- Observing procedures performed by the internal audit function
- Reviewing the internal audit function's work program and working papers

.A35 The more judgment involved, the higher the assessed risk of material misstatement, the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, or the lower the level of competence of the internal audit function, the more audit procedures are needed to be performed by the external auditor on the overall body of work of the internal audit function to support the decision to use the work of the function in obtaining sufficient appropriate audit evidence on which to base the audit opinion.

Reperformance (Ref: par. .23)

.A36 For purposes of this section, *reperformance* involves the external auditor's independent execution of procedures to validate the conclusions reached by the internal audit function.

[13]Paragraphs .17 and .A22 of section 200.

[14]Paragraph .A120 of section 315A.

This objective may be accomplished by examining items already examined by the internal audit function or sufficient other similar items not actually examined by the internal audit function. Reperformance provides more persuasive evidence regarding the adequacy of the work of the internal audit function compared to other procedures the external auditor may perform, as described in paragraph .A34. Although it is not necessary for the external auditor to reperform some of the work of the internal audit function in each area that is being used, some reperformance is required on the body of work of the internal audit function as a whole that the external auditor intends to use in accordance with paragraph .23. The external auditor is more likely to focus reperformance in those areas where more judgment was exercised by the internal audit function in planning, performing, and evaluating the results of the audit procedures and in areas of higher risk of material misstatement.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit (Ref: par. .25–.26)

.A37 The external auditor may obtain direct assistance from the internal auditors to carry out audit procedures that otherwise would be performed directly by the external auditors themselves. In such circumstances, the internal auditors are under the direction, supervision, and review of the external auditor.

.A38 In accordance with paragraph .25, the external auditor evaluates the existence and significance of any threats to the objectivity and level of competence of the internal auditors who will be providing direct assistance on the audit before assigning them to specific tasks. Evaluating the existence and significance of threats to objectivity includes evaluating safeguards applied to reduce or eliminate the threats.

.A39 As stated in paragraph .A7, *objectivity* refers to the ability to perform the proposed work without allowing bias, conflict of interest, or undue influence of others to override professional judgments. In evaluating the existence and significance of any threats to the objectivity of an individual internal auditor, the external auditor may consider the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, including, for example, policies and procedures addressing association with the division or department in the entity to which the work relates. Additionally, other matters may come to the external auditor's attention that may be relevant to the external auditor's evaluation of the objectivity of the internal auditor.

.A40 In evaluating the level of competence of an internal auditor, many of the factors in paragraph .A8 may also be relevant but in the context of individual internal auditors and the work to which they may be assigned.

.A41 The external auditor may determine it is necessary to specifically instruct the internal auditors to keep confidential specific matters, as instructed by the external auditor, and to inform the external auditor of any threat to their objectivity. In some situations, the external auditor may determine it to be necessary to request written acknowledgment from the internal auditors of having understood such instruction by the external auditor.

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance (Ref: par. .27)

.A42 Paragraphs .A18–.A27 also provide relevant guidance in determining the nature and extent of work that may be assigned to the internal auditors providing direct assistance. As the materiality of the financial statement amounts increases and either the assessed risks of material misstatement or the amount of judgment involved increases, the need for the external auditor to perform procedures directly increases. As these factors decrease, the need for the external auditor to perform procedures directly decreases.

.A43 In determining the nature of work that may be assigned to internal auditors providing direct assistance, the external auditor is careful to limit such work to those areas that would be appropriate for internal auditors to be assigned. Examples of activities and tasks that would not be appropriate for internal auditors to provide direct assistance include the following:

- Making required inquiries of entity personnel or those charged with governance related to the identification of fraud risks and determining the procedures to respond to such risks[15]
- Determination of unpredictable audit procedures as addressed in section 240

Using Internal Auditors to Provide Direct Assistance (Ref: par. .18 and .29–.31)

.A44 If the external auditor plans to use the internal audit function in obtaining audit evidence and also plans to use internal auditors to provide direct assistance, only one evaluation would be necessary to address the requirements of paragraphs .18 and .29.

.A45 The written acknowledgment required by paragraph .30 may be included within the audit engagement letter (or other suitable form of written agreement of the terms of engagement)[16] or could be included in a separate document prepared by the external auditor and acknowledged in writing by management or those charged with governance, as appropriate.

.A46 The direction, supervision, and review by the external auditor of the audit procedures performed by the internal auditors need to be sufficient in order for the external auditor to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions based on that work. Because individuals in the internal audit function are not independent of the entity as is required of the external auditor when expressing an opinion on financial statements, the external auditor's involvement in these circumstances may be of a different nature or more extensive than if members of the engagement team perform the work.

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[15]Paragraphs .17–.21 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

[16]See paragraph .10 of section 210A, *Terms of Engagement*.

.A47 The nature, timing, and extent of direction, supervision, and review of the audit procedures performed by the internal auditors is also dependent on the outcome of the external auditor's evaluation of the objectivity and the level of competence of, and the nature and extent of audit procedures to be performed by, the internal auditors. Directing and supervising the internal auditors involves informing them of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. In reviewing the work performed by the internal auditors, the external auditor's considerations include whether the evidence obtained is sufficient and appropriate in the circumstances, and that it supports the conclusions reached.

AU-C Section 620

Using the Work of an Auditor's Specialist

Source: SAS No. 122; SAS No. 144; SAS No. 145.

See section 9620 for interpretations of this section.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the Auditing Standards Board issued Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

.02 This section does not address

a. situations in which the engagement team includes a member or consults an individual or organization with expertise in a specialized area of accounting or auditing, which are addressed in section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, and section 300, *Planning an Audit*,[1,2] or

[1]Paragraphs .A10 and .A20–.A22 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

b. the auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's specialist), which is addressed in section 501, *Audit Evidence — Specific Considerations for Selected Items*.[3]

[Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

The Auditor's Responsibility for the Audit Opinion

.03 The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's specialist. Nonetheless, if the auditor using the work of an auditor's specialist, having followed this section, concludes that the work of that specialist is adequate for the auditor's purposes, the auditor may accept that specialist's findings or conclusions in the specialist's field as appropriate audit evidence.

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.05 The objectives of the auditor are

a. to determine whether to use the work of an auditor's specialist and

b. if using the work of an auditor's specialist, to determine whether that work is adequate for the auditor's purposes.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Auditor's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either an auditor's internal specialist (who is a partner[4] or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist. (Ref: par. .A1–.A4)

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[2]Paragraph .12 of section 300, *Planning an Audit*.

[3]Paragraph .27 of section 501, *Audit Evidence — Specific Considerations for Selected Items*. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[4]*Partner* and *firm* should be read as referring to their governmental equivalents when relevant.

Expertise. Skills, knowledge, and experience in a particular field.

Management's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

Requirements

Determining the Need for an Auditor's Specialist

.07 If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor should determine whether to use the work of an auditor's specialist. (Ref: par. .A5–.A10)

Nature, Timing, and Extent of Audit Procedures

.08 The nature, timing, and extent of the auditor's procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

a. the nature of the matter to which the work of the auditor's specialist relates;

b. the risks of material misstatement in the matter to which the work of the auditor's specialist relates;

c. the significance of the work of the auditor's specialist in the context of the audit;

d. the auditor's knowledge of, and experience with, previous work performed by the auditor's specialist; and

e. whether the auditor's specialist is subject to the auditor's firm's quality control policies and procedures. (Ref: par. .A12–.A14)

The Competence, Capabilities, and Objectivity of the Auditor's Specialist

.09 The auditor should evaluate whether the auditor's specialist has the necessary competence, capabilities, and objectivity for the auditor's purposes. In the case of an auditor's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the auditor's specialist. (Ref: par. .A15–.A22)

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist

.10 The auditor should obtain a sufficient understanding of the field of expertise of the auditor's specialist to enable the auditor to (Ref: par. .A23–.A24)

a. determine the nature, scope, and objectives of the work of the auditor's specialist for the auditor's purposes and

b. evaluate the adequacy of that work for the auditor's purposes.

Agreement With the Auditor's Specialist

.11 The auditor should agree, in writing when appropriate, with the auditor's specialist regarding (Ref: par. .A25–.A29)

a. the nature, scope, and objectives of the work of the auditor's specialist; (Ref: par. .A30)

b. the respective roles and responsibilities of the auditor and the auditor's specialist; (Ref: par. .A31–.A32)

c. the nature, timing, and extent of communication between the auditor and the auditor's specialist, including the form of any report to be provided by the auditor's specialist; and (Ref: par. .A33)

d. the need for the auditor's specialist to observe confidentiality requirements. (Ref: par. .A34)

Evaluating the Adequacy of the Work of the Auditor's Specialist

.12 The auditor should evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes, including

a. the relevance and reasonableness of the findings and conclusions of the auditor's specialist and their consistency with other audit evidence. (Ref: par. .A35–.A37)

b. If the work of the auditor's specialist involves the use of significant assumptions and methods,

    i. obtaining an understanding of those assumptions and methods and

    ii. evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the specialist, and in relation to the auditor's other findings and conclusions. (Ref: par. .A38–.A40)

c. If the work of the auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, the relevance, completeness, and accuracy of that source data. (Ref: par. .A41–.A42)

.13 If the auditor determines that the work of the auditor's specialist is not adequate for the auditor's purposes, the auditor should (Ref: par. .A44)

a. agree with the auditor's specialist on the nature and extent of further work to be performed by the auditor's specialist or

b. perform additional audit procedures appropriate to the circumstances.

Reference to the Auditor's Specialist in the Auditor's Report

.14 The auditor should not refer to the work of an auditor's specialist in an auditor's report containing an unmodified opinion.

.15 If the auditor makes reference to the work of an auditor's external specialist in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor should indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. (Ref: par. .A46)

Application and Other Explanatory Material

Definitions

Auditor's Specialist (Ref: par. .06)

.A1 Expertise in a field other than accounting or auditing may include expertise regarding such matters as the following:

- The valuation of complex financial instruments and nonfinancial assets and liabilities measured at fair value such as land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations, and assets that may have been impaired
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans
- The estimation of oil and other mineral reserves
- The valuation of environmental liabilities and site cleanup costs
- The interpretation of contracts, laws, and regulations
- The analysis of complex or unusual tax compliance issues
- The determination of physical characteristics relating to quantity on hand or condition (for example, quantity or condition of minerals, or materials stored in stockpiles)

.A2 In many cases, distinguishing between expertise in accounting or auditing and expertise in another field will be straightforward, even when this involves a specialized area of accounting or auditing.[5] For example, an individual with expertise in applying methods of accounting for deferred income tax can often be easily distinguished from a specialist in taxation law. The former is not a specialist for the purposes of this section because this constitutes accounting expertise; the latter is a specialist for the purposes of this

[5]Paragraphs .A18–.A19 of section 300 address the auditor's determination of the extent of involvement of professionals possessing specialized skills.

section because this constitutes legal expertise. Similar distinctions also may be able to be made in other areas (for example, between expertise in methods of accounting for financial instruments and expertise in complex modeling for the purpose of valuing financial instruments). However, in some cases, particularly those involving an emerging area of accounting or auditing expertise, distinguishing between specialized areas of accounting or auditing and expertise in another field will be a matter of professional judgment. Applicable professional rules and standards regarding education and competency requirements for accountants and auditors may assist the auditor in exercising that judgment.

.A3 An individual may possess expertise in accounting or auditing, as well as expertise in a field other than accounting or auditing (for example, an actuary also may be an accountant). In that circumstance, the determination of whether that individual is an auditor or an auditor's specialist depends on the nature of the work performed by that individual that the auditor is using for purposes of the audit.

.A4 It is necessary to apply professional judgment when considering how the requirements of this section are affected by the fact that an auditor's specialist may be either an individual or an organization. For example, when evaluating the competence, capabilities, and objectivity of an auditor's specialist, it may be that the specialist is an organization the auditor has previously used, but the auditor has no prior experience with the individual specialist assigned by the organization for the particular engagement, or it may be the reverse (that is, the auditor may be familiar with the work of an individual specialist but not with the organization that specialist has joined). In either case, both the personal attributes of the individual and the managerial attributes of the organization (such as systems of quality control the organization implements) may be relevant to the auditor's evaluation.

Determining the Need for an Auditor's Specialist (Ref: par. .07)

.A5 An auditor's specialist may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control
- Identifying and assessing the risks of material misstatement
- Determining and implementing overall responses to assessed risks at the financial statement level
- Designing and performing additional audit procedures to respond to assessed risks at the relevant assertion level, which may comprise tests of controls or substantive procedures
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A6 The risks of material misstatement may increase when expertise in a field other than accounting is needed for management to prepare the financial statements, for example, because this may indicate some complexity or because management may not possess knowledge of the field of expertise. If, in preparing the financial statements, management does not possess the necessary expertise, a management's specialist may be used in addressing those risks. Relevant controls, including controls that relate to the work of a management's specialist, if any, also may reduce the risks of material misstatement.

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by section 220A to be satisfied that the engagement team and any external auditor's specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities to perform the audit engagement.[6] Further, the auditor is required by section 300 to ascertain the nature, timing, and extent of resources necessary to perform the engagement.[7] The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

.A8 An auditor who is not a specialist in a relevant field other than accounting or auditing may nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor's specialist. This understanding may be obtained through, for example

- experience in auditing entities that require such expertise in the preparation of their financial statements.
- education or professional development in the particular field. This may include formal courses or discussion with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's specialist regarding a specific set of circumstances encountered on the engagement in which that specialist is given all the relevant facts that will enable the specialist to provide informed advice about the particular matter (see section 220A).[8]

.A9 In other cases, however, the auditor may determine that it is necessary, or may choose, to use an auditor's specialist to assist in obtaining sufficient appropriate audit evidence. Considerations when deciding whether to use an auditor's specialist may include the following:

- Whether management has used a specialist in preparing the financial statements (see paragraph .A10)

[6]Paragraph .16 of section 220A.

[7]Paragraph .08*e* of section 300.

[8]Paragraph .A21 of section 220A.

- The nature and significance of the matter, including its complexity
- The risks of material misstatement of the matter
- The expected nature of procedures to respond to identified risks, including the auditor's knowledge of, and experience with, the work of specialists regarding such matters and the availability of alternative sources of audit evidence

.A10 When management uses a management's specialist in preparing the financial statements, the auditor's decision on whether to use an auditor's specialist also may be influenced by such factors as the following:

- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the management's specialist (including, when applicable, the organization that employs the individual specialist), thereby influencing the work of the management's specialist
- The competence and capabilities of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements
- Any controls within the entity over the work of the management's specialist
- The auditor's ability to evaluate the work and findings of the management's specialist without the assistance of an auditor's specialist.

Section 501 addresses the effect of the competence, capabilities, and objectivity of management's specialists on the reliability of audit evidence.[9] [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Nature, Timing, and Extent of Audit Procedures (Ref: par. .08)

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.

[9]Paragraph .27 of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.
- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's quality control policies and procedures.

The Auditor's Firm's Quality Control Policies and Procedures (Ref: par. .08e)

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff, of the auditor's firm and, therefore, subject to the quality control policies and procedures of that firm in accordance with QM section 10A, *A Firm's System of Quality Control*.[10] An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the auditor's firm.

.A13 In accordance with section 220A, engagement teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.[11] The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.
- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those pertaining to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm processes, such as protocols for scoping the work of the auditor's internal specialists, may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

Such reliance does not reduce the auditor's responsibility to meet the requirements of this section.

.A14 An auditor's external specialist is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with QM section 10A.[12]

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[10]Paragraph .13 of QM section 10A, *A Firm's System of Quality Control* .

[11]Paragraph .05 of section 220A.

[12]Paragraph .13 of QM section 10A.

The Competence, Capabilities, and Objectivity of the Auditor's Specialist (Ref: par. .09)

.A15 The competence, capabilities, and objectivity of an auditor's specialist are factors that significantly affect whether the work of the auditor's specialist will be adequate for the auditor's purposes. Competence relates to the nature and level of expertise of the auditor's specialist. Capability relates to the ability of the auditor's specialist to exercise that competence in the circumstances of the engagement. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the auditor's specialist.

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The quality control policies and procedures of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

.A17 Matters relevant to evaluating the competence, capabilities, and objectivity of the auditor's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements (for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation).

.A18 Other matters that may be relevant include the following:

- The relevance of the competence of the auditor's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations.
- The competence of the auditor's specialist with respect to relevant accounting and auditing requirements (for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework).
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider

the initial evaluation of the competence, capabilities, and objectivity of the auditor's specialist as the audit progresses.

.A19 A broad range of circumstances may threaten objectivity (for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats). Safeguards may eliminate or reduce such threats and may be created by external structures (for example, the profession, legislation, or regulation of the auditor's specialist) or by the work environment of the auditor's specialist (for example, quality control policies and procedures). There also may be safeguards specific to the audit engagement.

.A20 The evaluation of the significance of threats to objectivity and of whether a need exists for safeguards may depend upon the role of the auditor's specialist and the significance of the specialist's work in the context of the audit. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level (for example, if a proposed auditor's specialist is an individual or organization that has played a significant role in preparing the information that is being audited [that is, if the proposed auditor's specialist is a management's specialist]). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A21 When evaluating the objectivity of an auditor's external specialist, in addition to considering information obtained from procedures performed in accordance with section 550, *Related Parties*, the auditor may

a. inquire of the entity and the auditor's specialist about any known interests or relationships that the entity has with the auditor's external specialist (including, when applicable, the organization that employs the individual specialist) that may affect that specialist's objectivity

b. discuss with that specialist any applicable safeguards, including any professional requirements that apply to that specialist, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the auditor's specialist include the following:

   i. Financial interests

   ii. Business and personal relationships between the entity and the individual specialist and between the entity and the organization that employs the individual specialist

   iii. Provision of other services to the entity by the specialist, including by the organization in the case of an external specialist that is an organization

In some cases, the auditor may obtain a written representation from the auditor's external specialist about any interests or relationships with the entity of which that specialist is aware. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A22 If the auditor believes a relationship between the entity and the auditor's external specialist might impair the objectivity of that specialist, the auditor may perform, or engage another auditor's specialist to perform, additional procedures with respect to some or all of the assumptions, methods, or findings of the auditor's external specialist to determine that the findings are reasonable. The nature and extent of the additional procedures depend on the degree of objectivity of the auditor's external specialist. The need for additional procedures to obtain sufficient appropriate audit evidence increases as the degree of objectivity decreases. For example, if the auditor's external specialist has a low degree of objectivity, it may be necessary for the auditor to perform procedures similar to those used to evaluate the appropriateness of the work of a management's specialist as audit evidence.[13] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist (Ref: par. .10)

.A23 The auditor may obtain an understanding of the field of expertise of the auditor's specialist through the means described in paragraph .A8 or through discussion with the auditor's specialist.

.A24 Aspects of the field of the auditor's specialist relevant to the auditor's understanding may include the following:

- Whether that field of the auditor's specialist has areas of specialty within it that are relevant to the audit (see paragraph .A18)
- Whether any professional or other standards and regulatory or legal requirements apply
- What assumptions and methods, including models, when applicable, are used by the auditor's specialist, and whether they are generally accepted within that field of the auditor's specialist and appropriate for financial reporting purposes
- The nature of internal and external data or information the auditor's specialist uses

Agreement With the Auditor's Specialist (Ref: par. .11)

.A25 The following matters may vary considerably with the circumstances:

a. The nature, scope, and objectives of the work of the auditor's specialist

b. The respective roles and responsibilities of the auditor and the auditor's specialist

c. The nature, timing, and extent of communication between the auditor and the auditor's specialist.

[13] See paragraphs .26 and .A69–.A83 of section 501, *Audit Evidence — Specific Considerations for Selected Items*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Therefore, it is required that these matters are agreed between the auditor and the auditor's specialist regardless of whether the specialist is an auditor's external specialist or internal specialist.

.A26 The matters noted in paragraph .08 may affect the level of detail and formality of the agreement between the auditor and the auditor's specialist, including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for a more detailed agreement than would otherwise be the case or for the agreement to be in writing:

- The auditor's specialist will have access to sensitive or confidential entity information.
- The respective roles or responsibilities of the auditor and the auditor's specialist are different from those normally expected.
- Multijurisdictional legal or regulatory requirements apply.
- The matter to which the work of the auditor's specialist relates is highly complex.
- The auditor has not previously used work performed by the auditor's specialist.
- The auditor's use of the work of the auditor's specialist and its significance in the context of the audit is extensive.

.A27 In establishing the agreement with the auditor's specialist, an important consideration is whether the work of the auditor's specialist is subject to any reservation, limitation, or restriction and whether this has implications for the auditor.

.A28 The agreement between the auditor and an auditor's external specialist is generally in the form of an engagement letter. The appendix "Considerations for Agreement Between the Auditor and an Auditor's External Specialist" lists matters that the auditor may consider for inclusion in such an engagement letter or in any other form of agreement with an auditor's external specialist.

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example

- planning memoranda or related working papers, such as the audit program.
- the policies and procedures of the auditor's firm. In the case of an auditor's internal specialist, the established policies and procedures to which the auditor's specialist is subject may include particular policies and procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies and procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

Nature, Scope, and Objectives of Work (Ref: par. .11a)

.A30 It often may be relevant when agreeing on the nature, scope, and objectives of the work of the auditor's specialist to include discussion of any relevant technical performance standards or other professional or industry requirements that the auditor's specialist will follow. Other matters that could affect the nature, scope, and objectives of the auditor's specialist's work include, as applicable, information about the entity and its environment, the entity's processes for developing the related accounting estimate, the entity's use of specialists in developing the estimate, relevant requirements of the applicable financial reporting framework, and possible accounting and auditing issues. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Respective Roles and Responsibilities (Ref: par. .11b)

.A31 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist may include the following:

- The degree of responsibility of the auditor's specialist for the following:
  - — Testing of source data, for example, testing data produced by the entity, or evaluating the relevance and reliability of data from sources external to the entity
  - — Evaluating the significant assumptions used by the entity or management's specialist, or developing the auditor's specialist's own assumptions
  - — Evaluating the methods used by the entity or management's specialist, or using the auditor's specialist's own methods
- Consent for the auditor to discuss the findings or conclusions of the auditor's specialist with the entity and others and to include details of the findings or conclusions of the auditor's specialist in the basis for a modified opinion in the auditor's report, if necessary (see paragraph .A46)
- Any agreement to inform the auditor's specialist of the auditor's conclusions concerning the work of the auditor's specialist

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Working Papers

.A32 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist also may include agreement about access to, and retention of, each other's working papers. When the auditor uses the work of an internal specialist, the working papers of the auditor's specialist form part of the audit documentation. Subject to any agreement to the contrary, the auditor's external specialist's working papers are its own and do not form part of the audit documentation.

Communication (Ref: par. .11c)

.A33 Effective two way communication facilitates the proper integration of the nature, timing, and extent of the procedures of the auditor's specialist with other work on the audit and appropriate modification of the objectives of the auditor's specialist during the course of the audit. For example, when the work of the auditor's specialist relates to the auditor's conclusions regarding a significant risk, both a formal written report at the conclusion of the work of the auditor's specialist and oral reports as the work progresses may be appropriate. Identification of specific partners or staff who will interact with the auditor's specialist and procedures for communication between the auditor's specialist and the entity assist timely and effective communication, particularly on larger engagements.

Confidentiality (Ref: par. .11d)

.A34 It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's specialist.[14] Additional requirements may be imposed by law or regulation. The entity also may have requested that specific confidentiality provisions be agreed with the auditor's external specialists.

Evaluating the Adequacy of the Work of the Auditor's Specialist (Ref: par. .12)

.A35 The auditor's evaluation of the competence, capabilities, and objectivity of the auditor's specialist; the auditor's familiarity with the field of expertise of the auditor's specialist; the risk of material misstatement in the matter to which the specialist's work relates; the nature of the work performed by the auditor's specialist; and the significance of the auditor's specialist's work in the context of the audit affect the nature, timing, and extent of audit procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

The Findings and Conclusions of the Auditor's Specialist (Ref: par. .12a)

.A36 Specific procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes may include the following:

- Making inquiries of the auditor's specialist
- Reviewing the working papers and reports of the auditor's specialist
- Performing corroborative procedures, such as
  - — observing the work of the auditor's specialist;
  - — examining published data, such as statistical reports from reputable, authoritative sources;
  - — confirming relevant matters with third parties;
  - — performing detailed analytical procedures; and

[14]ET section 1.700.040, *Disclosing Information to a Third-Party Service Provider*. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Footnote renumbered by the issuance of SAS No. 144, June 2021.]

   — reperforming calculations

- Engaging in discussion with another specialist with relevant expertise when, for example, the findings or conclusions of the auditor's specialist are not consistent with other audit evidence

- Discussing the report of the auditor's specialist with management

.A37 Relevant factors when evaluating the relevance and reasonableness of the findings or conclusions of the auditor's specialist, whether in a report or other form, may include whether they are

- presented in a manner that is consistent with any standards of the profession or industry of the auditor's specialist;

- clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed, and standards applied;

- based on an appropriate period and take into account subsequent events, when relevant; and

- based on appropriate consideration of errors or deviations encountered by the auditor's specialist.

Assumptions, Methods, and Source Data

Assumptions and Methods (Ref: par. .12b)

.A38 When the purpose of the work of the auditor's specialist is to evaluate underlying assumptions and methods, including models, when applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed to evaluating whether the auditor's specialist has adequately reviewed those assumptions and methods. When the purpose of the work of the auditor's specialist is to develop an auditor's point estimate or an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models, when appropriate, used by the auditor's specialist.

.A39 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, discusses the assumptions and methods used by management in making accounting estimates, including the use, in some cases, of highly specialized, entity-developed models.[15] Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it also may assist the auditor when evaluating the assumptions and methods of an auditor's specialist.

[15]Paragraphs .08, .13, and .15 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*. [Footnote renumbered by the issuance of SAS No. 144, June 2021.]

.A40 When the work of an auditor's specialist involves the use of significant assumptions and methods, the appropriateness and reasonableness of those assumptions and methods used and their application are the responsibility of the auditor's specialist. The auditor is responsible for obtaining an understanding of those assumptions and methods and evaluating the relevance and reasonableness of those assumptions and methods in the circumstances.[16] Factors relevant to the auditor's evaluation of those assumptions and methods include whether they are

- generally accepted within the field of the auditor's specialist;
- consistent with the requirements of the applicable financial reporting framework;
- dependent on the use of specialized models;[17] and
- consistent with those of management and, if not, the reason for, and effects of, the differences.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Source Data Used by the Auditor's Specialist (Ref: par. .12c)

.A41 Section 500 discusses the auditor's responsibility to consider the relevance and reliability of information to be used as audit evidence, including its source.[18] When the work of an auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, procedures such as the following may be used to test that data:

- Verifying the origin of the data, including obtaining an understanding of and, when applicable, testing the internal controls over the data and, when relevant, its transmission to the auditor's specialist
- Reviewing the data for completeness and internal consistency

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A42 In many cases, the auditor may test source data. However, in other cases, when the nature of the source data used by an auditor's specialist is highly technical in relation to the field of the auditor's specialist, that specialist may test the source data. If the auditor's specialist has tested the source data, inquiry of the auditor's specialist by the auditor or supervision or review of the test of the auditor's specialist may be an appropriate way for the auditor to evaluate that data's relevance, completeness, and accuracy.

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[16]Paragraph .13 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

[17]Paragraph .14 of section 540A addresses the auditor's consideration of whether specialized skills or knowledge with regard to one or more aspects of the accounting estimates is required in order to obtain sufficient appropriate audit evidence. [Footnote renumbered by the issuance of SAS No. 144, June 2021.]

[18]Paragraphs .07 and .A12–.A24 of section 500, *Audit Evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Inadequate Work (Ref: par. .13)

.A43 Examples of situations in which the auditor may conclude that the work of the auditor's specialist is not adequate for the auditor's purposes include the following:

- The specialist's use of data or significant assumptions was not based on consideration of relevant information available to the specialist.
- The methods used by the specialist were not appropriate.
- The specialist's work was not performed in accordance with the auditor's instructions.
- The specialist's findings and conclusions are inconsistent with
  - — the results of the work performed by the specialist,
  - — other evidence obtained by the auditor, or
  - — the auditor's understanding of the entity and its environment.
- The specialist's report, or equivalent documentation, contains restrictions, disclaimers, or limitations that affect the auditor's use of the report or work.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A44 If the auditor concludes that the work of the auditor's specialist is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures required by paragraph .13, which may involve additional work being performed by both the auditor's specialist and the auditor or include employing or engaging another specialist, it may be necessary to express a modified opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

Reference to the Auditor's Specialist in the Auditor's Report (Ref: par. .14–.15)

.A45 When key audit matters are included in the auditor's report, the auditor may decide to refer to the work of an auditor's specialist in the description of a key audit matter (for example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may highlight that the auditor used an auditor's internal or external specialist). Such a reference does not reduce the auditor's responsibility for the opinion on the financial statements and is, therefore, not inconsistent, in and of itself, with paragraphs .14–.15.[19] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

[19] See paragraph .A48 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A46 It may be appropriate to refer to the auditor's external specialist in an auditor's report containing a modified opinion to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor's specialist before making such a reference. [Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

Appendix — Considerations for Agreement Between the Auditor and an Auditor's External Specialist (Ref: par. .A28)

.A47 This appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external specialist. The following list is illustrative and is not exhaustive; it is intended only to be a guide that may be used in conjunction with the considerations outlined in this section. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list also may be of assistance in considering the matters to be included in an agreement with an auditor's internal specialist.

Nature, Scope, and Objectives of the Auditor's External Specialist's Work

The following matters are examples of the nature, scope, and objectives of the auditor's external specialist's work:

- The nature and scope of the procedures to be performed by the auditor's external specialist
- The objectives of the auditor's external specialist's work in the context of materiality and risk considerations concerning the matter to which the auditor's external specialist's work relates and, when relevant, the applicable financial reporting framework
- Any relevant technical performance standards or other professional or industry requirements the auditor's external specialist will follow
- The assumptions and methods, including models, when applicable, the auditor's external specialist will use and their authority
- The effective date of, or, when applicable, the testing period for, the subject matter of the auditor's external specialist's work and requirements regarding subsequent events

The Respective Roles and Responsibilities of the Auditor and the Auditor's External Specialist

The following matters are examples of the respective roles and responsibilities of the auditor and the auditor's external specialist:

- Relevant auditing and accounting standards and relevant regulatory or legal requirements
- The consent of the auditor's external specialist to the auditor's intended use of the report of the auditor's specialist, including any reference to it or disclosure of it to others (for example, reference to it in the basis for a modified opinion in the auditor's report, if necessary, or disclosure of it to management or an audit committee)
- The nature and extent of the auditor's review of the auditor's external specialist's work
- Whether the auditor or the auditor's external specialist will test source data

- The auditor's external specialist's access to the entity's records, files, personnel, and specialists engaged by the entity
- Procedures for communication between the auditor's external specialist and the entity
- The auditor's and the auditor's external specialist's access to each other's working papers
- Ownership and control of working papers during and after the engagement, including any file retention requirements
- The auditor's external specialist's responsibility to perform work with due skill and care
- The auditor's external specialist's competence and capability to perform the work
- The expectation that the auditor's external specialist will use all knowledge that the specialist has that is relevant to the audit or, if not, will inform the auditor
- Any restriction on the auditor's external specialist's association with the auditor's report
- Any agreement to inform the auditor's external specialist of the auditor's conclusions concerning the work of the auditor's external specialist

Communications and Reporting

The following matters are examples of communications and reporting:

- Methods and frequency of communications, including the following:
  - — How the auditor's external specialist's findings or conclusions will be reported (for example, written report, oral report, ongoing input to the engagement team)
  - — Identification of specific persons within the engagement team who will liaise with the auditor's external specialist
- When the auditor's external specialist will complete the work and report findings or conclusions to the auditor
- The auditor's external specialist's responsibility to communicate promptly any potential delay in completing the work and any potential reservation or limitation on the findings and conclusions of the auditor's specialist
- The auditor's external specialist's responsibility to communicate promptly instances in which the entity restricts the access to records, files, personnel of the auditor's external specialist, or management's specialists engaged by the entity
- The auditor's external specialist's responsibility to communicate to the auditor all information that the auditor's external specialist believes may be relevant to the audit, including any changes in circumstances previously communicated

- The auditor's external specialist's responsibility to communicate circumstances that may create threats to the objectivity of the auditor's external specialist and any relevant safeguards that may eliminate or reduce such threats to an acceptable level

Confidentiality

The following matters are examples of confidentiality:

- The need for the auditor's specialist to observe confidentiality requirements, including the following:
  - — The confidentiality provisions of relevant ethical requirements that apply to the auditor
  - — Additional requirements that may be imposed by law or regulation, if any (for example, specific confidentiality provisions requested by the entity)

[Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

AU-C Section 9620

Using the Work of an Auditor's Specialist: Auditing Interpretations of Section 620

Interpretation No. 1, "The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40," has not been updated to reflect the issuance of Financial Accounting Standards Board (FASB) Statement No. 166, *Accounting for Transfers of Financial Assets*. FASB Statement No. 166 was incorporated into FASB *Accounting Standards Codification* (ASC) by FASB Accounting Standards Update No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, and is discussed in FASB ASC 860, *Transfers and Servicing*.

In addition, this interpretation has not been updated for changes to the Federal Deposit Insurance Corporation's (FDIC's) safe harbor for financial assets transferred in connection with securitizations and participations. The FDIC's final amendments to the safe harbor, *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010* (www.fdic.gov/news/news/press/2010/pr10216.html), were issued in September 2010. The safe harbor provides important protections for securitizations and participations by confirming that in the event of a bank failure, the FDIC would not try to reclaim loans transferred into such transactions.

In light of the issuance of FASB Statement No. 166 and the FDIC's changes to the safe harbor, the AICPA's Auditing Standards Board is currently in the process of revising this interpretation. Auditors should be alert for such revisions; however, the guidance in this interpretation continues to be relevant.

1. The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40

.01 *Introduction* — Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 860,[1] *Transfers and Servicing*, requires that a transferor of financial assets must surrender control over the financial assets to account for the transfer as a sale. According to FASB ASC 860-10-40-5(a), one of several conditions that must be met to provide evidence of surrender of control is that the transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

Paragraphs 8–10 of FASB ASC 860-10-40 describe in greater detail the evidence required to support management's assertion that transferred financial assets have been isolated:

> Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any *consolidated affiliate of the transferor*[2] that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership (see FASB ASC 860-10-55-23[c]).The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. FASB ASC 860 does not provide guidance as to the type and amount of evidence that must be obtained to conclude that transferred financial assets have been isolated from the transferor. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or SPE might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law.

A determination about whether the isolation criterion has been met to support a conclusion regarding surrender of control is largely a matter of law. This aspect of surrender of control, therefore, is assessed primarily from a legal perspective.

.02 *Effective Date and Applicability* — This interpretation is effective for auditing procedures related to transfers of financial assets that are required to be accounted for under FASB ASC 860.[3]

.03 *Question* — What are the auditor's responsibilities in determining whether to use the work of a legal specialist[4] to obtain persuasive evidence to support management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a)?

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[1][Footnote deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[2]The Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) glossary defines *consolidated affiliate of the transferor* as "an entity whose assets and liabilities are included with those of the transferor in the consolidated, combined, or other financial statements being presented." [Footnote added, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[3][Footnote renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.04 *Interpretation* — Section 501, *Audit Evidence — Specific Considerations for Selected Items*, states that the "preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements."[5]

.05 Use of a management's specialist may not be necessary to obtain appropriate audit evidence to support management's assertion that the isolation criterion is met in certain situations, such as when there is a routine transfer of financial assets that does not result in any continuing involvement by the transferor.[6]

.06 Many transfers of financial assets involve complex legal structures, continuing involvement by the transferor, or other legal issues that, in the auditor's judgment, make it difficult to determine whether the isolation criterion is met. In these situations, use of a legal specialist usually is necessary. A legal specialist formulating an opinion about whether a transfer isolates the transferred assets beyond the reach of the transferor and its creditors may consider, among other things, the structure of the transaction taken as a whole, the nature of any continuing involvement, the type of insolvency or other receivership proceedings to which the transferor might become subject, and other factors pertinent under applicable law.

.07 If a legal opinion is used as evidence to support the accounting conclusion related to multiple transfers under a single structure, and such transfers occur over an extended period of time under that structure, the auditor is required to evaluate the appropriateness of the legal opinion,[7] which includes evaluating the need for management to obtain periodic updates of that opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may change the applicability of the previous opinion to such transfers. The auditor also is required to evaluate the need for management to obtain periodic updates of an opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may affect the conclusions reached in the previous opinion in the case of other transfers (see FASB ASC 860-10-40-41 and FASB ASC 860-20-25).

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[4]Client's internal or external attorney who is knowledgeable about relevant sections of the U.S. Bankruptcy Code and other federal, state, or foreign laws, as applicable. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[5]Paragraph .A70 of section 501, *Audit Evidence — Specific Considerations for Selected Items*. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[6]FASB ASC 860-10-55-28 characterizes no continuing involvement with the transferred assets as "no servicing responsibilities, no participation in future cash flows, no recourse obligations other than standard representations and warranties that the financial assets transferred met the delivery requirements under the arrangement, no further involvement of any kind. The transferee is significantly limited in its ability to pledge or exchange the transferred assets."

If a contractual provision (such as a call or removal of accounts provision) gives the transferor the unilateral ability to require the return of specific financial assets, the auditor should consider the effect of FASB ASC 860-10-40-5(c). [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[7]Paragraph .27*c* of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.08 If management's assertion with respect to a new transaction is that the transaction structure is the same as a prior structure for which a legal opinion that complies with this interpretation was used as evidence to support an assertion that the transfer of assets met the isolation criterion, the auditor is required[8] to determine whether management needs to obtain an update of that opinion to confirm that there have been no changes in relevant law, applicable regulations, or in the pertinent facts of the transaction that may affect the applicability of the previous opinion to the new transaction.

.09 *Question* — If the auditor determines that the use of a management's legal specialist is required, what should he or she consider in assessing the adequacy of the legal opinion?

.10 *Interpretation* — In assessing the adequacy of the legal opinion, the auditor is required to evaluate the competence and capabilities[9] of the legal specialist to determine whether the legal specialist has experience with relevant matters, including knowledge of the U.S. Bankruptcy Code, and other federal, state, or foreign law, as applicable, as well as knowledge of the transaction upon which management's assertion is based. For transactions that may be affected by provisions of the Federal Deposit Insurance Act (FDIA), it is important to consider whether the legal specialist has experience with the rights and powers of receivers, conservators, and liquidating agents under that act. The auditor is required to obtain an understanding of the work of the specialist,[10] which includes obtaining an understanding of the assumptions that are used by the legal specialist, and make appropriate tests of any information that management provides to the legal specialist and upon which the specialist indicates it relied. For example, testing management's information underlying a legal specialist's assumption regarding the adequacy of consideration received may depend on the nature of the transaction and the relationship of the parties. When the legal specialist's opinion has assumed the adequacy of consideration for transfers from a particular legal entity to its wholly owned subsidiary, changes in the subsidiary's capital accounts plus other consideration generally would be sufficient audit evidence about the adequacy of consideration. In the case of other transfers, such as those that are not to a wholly owned subsidiary of a particular legal entity that is the transferor, obtaining additional audit evidence may be necessary to evaluate management's assertion with regard to the adequacy of consideration upon which the legal specialist relied, because changes in the transferee's capital accounts do not solely benefit the transferring entity.

.11 The auditor also is required to evaluate the appropriateness of that specialist work as audit evidence for the relevant assertion,[11] which includes considering the form and content of the documentation that the legal specialist provides and evaluating whether the legal specialist's findings support management's assertions with respect to the isolation criterion.

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[8]Paragraph .10 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[9]Paragraph .27*a* of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[10]Paragraph .27*b* of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[11]Paragraph .27*c* of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

The requirement in FASB ASC 860 regarding reasonable assurance that the transferred assets would be isolated provides the basis for what the auditor is required to consider in evaluating the work of a legal specialist.

.12 Findings of a legal specialist that relate to the isolation of transferred financial assets are often in the form of a reasoned legal opinion that is restricted to particular facts and circumstances relevant to the specific transaction. The reasoning of such opinion may rely upon analogy to legal precedents that may not involve facts and circumstances that are comparable to that specific transaction. It is important to consider the effect of any limitations or disclaimers of opinion in assessing the adequacy of any legal opinion.

.13 An example of the conclusions in a legal opinion for an entity that is subject to the U.S. Bankruptcy Code that provides persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in bankruptcy or other receivership, follows:

> *We believe (or it is our opinion) that* in a properly presented and argued case, as a legal matter, in the event the Seller were to become a Debtor, the transfer of the Financial Assets from the Seller to the Purchaser *would be considered to be a sale* (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of the Seller's estate for purposes of [the relevant sections] of the U.S. Bankruptcy Code.

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold (as described in the opinion) is an affiliate of the selling entity and may also apply in other situations as noted by the legal specialist. For example, if a so-called two-step structure has been used to achieve isolation, this paragraph usually will be required with respect to the transferee in the first step of such structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion.

> Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a proceeding under the U.S. Bankruptcy Code,[12] in which the Seller is a Debtor, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller in a case involving the insolvency of the Seller under the doctrine of substantive consolidation.

In the case of a transferor that is not entitled to become a debtor under the U.S. Bankruptcy Code, a legal opinion regarding whether the isolation criterion is met would consider whether isolation is satisfactorily achieved under the insolvency or receivership laws that apply to the transferor.

.14 Following are two examples of the conclusions in a legal opinion for an entity that is subject to receivership or conservatorship under provisions of the Federal Deposit Insurance Corporation (FDIC). The conclusions in these two examples provide persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in conservatorship or receivership. Insolvency and receivership laws applicable to depository institutions, and how those laws affect the legal isolation criterion, differ depending upon the nature of the depository institution and its chartering authority. Accordingly, legal opinions addressing the legal isolation criterion may be formulated in different ways to accommodate those differences.[13]

> Example 1. *We believe (or it is our opinion) that* in a properly presented and argued case, as a legal matter, in the event the Seller were to become subject to receivership or conservatorship, the transfer of the Financial Assets from the Seller to the Purchaser *would be considered to be a sale* (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of, or subject to repudiation, reclamation, recovery, or recharacterization by, the receiver or conservator appointed with respect to the Seller.[14]

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[12]For an entity subject to additional regulation (for example, a broker-dealer subject to the Securities Investor Protection Act), the legal opinion also generally should address the effect of such regulation and the policies of the regulators implementing such regulations (for example, the Securities Investor Protection Corporation). [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[13]For an entity subject to conservatorship or liquidation under the National Credit Union Act, the examples and discussion in this paragraph would be modified to make appropriate references to "liquidation" and "liquidating agent" and additional information relating to rights and regulations of the National Credit Union Administration. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[14]When the opinion indicates that isolation is achieved without reference to a true sale, the opinion also should provide reasonable assurance that the transferred assets are beyond the reach of the transferor and its creditors other than the transferee to the same extent that is provided in paragraph B of example 2. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

Example 2. The Federal Deposit Insurance Corporation (FDIC) has issued a regulation, 'Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation,' 12 CFR section 360.6 (the Rule). Based on and subject to the discussion, assumptions, and qualifications herein, it is our opinion that:

A. Following the appointment of the FDIC as the conservator or receiver for the Bank:

   i. The Rule will apply to the Transfers,

   ii. Under the Rule, the FDIC acting as conservator or receiver for the Bank could not, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. §1821(e), reclaim or recover the Transferred Assets from the Issuer or recharacterize the Transferred Assets as property of the Bank or of the conservatorship or receivership for the Bank,

   iii. Neither the FDIC (acting for itself as a creditor or as representative of the Bank or its shareholders or creditors) nor any creditor of the Bank would have the right, under any bankruptcy or insolvency law applicable in the conservatorship or receivership of the Bank, to avoid the Transfers, to recover the Transferred Assets, or to require the Transferred Assets to be turned over to the FDIC or such creditor, and

   iv. There is no other power exercisable by the FDIC as conservator or receiver for the Bank that would permit the FDIC as such conservator or receiver to reclaim or recover the Transferred Assets from the Issuer, or to recharacterize the Transferred Assets as property of the Bank or of the conservatorship or receivership for the Bank; provided, however, that we offer no opinion as to whether, in receivership, the FDIC or any creditor of the Bank may take any such actions if the Holders [*holders of beneficial interests in the transferred assets*] receive payment of the principal amount of the Interests and the interest earned thereon (at the contractual yield) through the date the Holders are so paid; and

B. Prior to the appointment of the FDIC as conservator or receiver for the Bank, the Bank and its other creditors would not have the right to reclaim or recover the Transferred Assets from the Issuer, except by the exercise of a contractual provision [insert appropriate citation] to require the transfer, or return, of the Transferred Assets that exists solely as a result of the contract between the Bank and the Issuer.[15]

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold or transferred (as described in the opinion) is an

[15] See the second paragraph of footnote 6.

Paragraph B is not required if the opinion includes both a conclusion, as set forth in example 1, that the transfer constitutes a "true sale" and the conclusions set forth in paragraph A of example 2. It is not necessary to include any provision of example 2 if the opinion is as set forth in example 1. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

affiliate of the selling entity and may also apply in other situations as noted by the legal specialist.[16] For example, if a so-called two-step structure has been used to achieve isolation, the following paragraph usually will be required with respect to the transferee in the first step of the structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion:

> Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a receivership, conservatorship, or liquidation proceeding in respect of the Seller, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller.

Certain powers to repudiate contracts, recover, reclaim, or recharacterize transferred assets as property of a transferor that are exercisable by the FDIC under the FDIA may, as of the date of the transfer, be limited by a regulation that may be repealed or amended only in respect of transfers occurring on or after the effective date of such repeal or amendment.[17] With respect to the powers of a receiver or conservator that may not be exercised under that regulation, it is acceptable for attorneys to rely upon the effectiveness of the limitation on such powers set forth in the applicable regulation, provided that the attorney states, based on reasonable assumptions, that (*a*) the affected transfer of financial assets meets all qualification requirements of the regulation, and (*b*) the regulation had not, as of the date of the opinion, been amended, repealed, or held inapplicable by a court with jurisdiction with respect to such transfer. The opinion should separately address any powers of repudiation, recovery, reclamation, or recharacterization exercisable by a receiver or conservator notwithstanding that regulation (for example, rights, powers, or remedies regarding transfers specifically excluded from the regulation) in a manner that provides the same level of assurance as would be provided in the case of opinions that conform with requirements of paragraph .13 of this interpretation, except that such opinion shall address powers arising under the FDIA. The considerations in the immediately preceding three sentences are adequately addressed either by the example 1 opinion or the example 2 opinion described in this paragraph or by the variations described in the second paragraph of footnote 15 and in footnote 16 of this interpretation.

.15 A legal letter that includes an inadequate opinion, inappropriate limitations, or a disclaimer of opinion, or that effectively limits the scope of the opinion to facts and circumstances that are not applicable to the transaction, does not provide persuasive

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[16]An additional substantive consolidation opinion is not required if the opinion states that its conclusion includes the inability to recover the transferred financial assets or recharacterize the transfer by application of the doctrine of "substantive consolidation." [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[17]The applicable regulation is 12 U.S. *Code of Federal Regulations* 360.6, effective September 11, 2000. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

evidence to support the entity's assertion that the transferred assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Likewise, a legal letter that includes conclusions that are expressed using some of the following language would not provide persuasive evidence that a transfer of financial assets has met the isolation criterion of FASB ASC 860-10-40-5(a) (see paragraphs .20–.21 of this interpretation):

- "We are unable to express an opinion..."
- "It is our opinion, based upon limited facts..."
- "We are of the view..." or "it appears..."
- "There is a reasonable basis to conclude that..."
- "In our opinion, the transfer would *either* be a sale *or* a grant of a perfected security interest..."[18]
- "In our opinion, there is a reasonable possibility..."
- "In our opinion, the transfer *should* be considered a sale..."
- "It is our opinion that the company will be able to assert meritorious arguments..."
- "In our opinion, it is more likely than not ..."
- "In our opinion, the transfer would *presumptively* be..."
- "In our opinion, it is probable that..."

Furthermore, conclusions about hypothetical transactions may not be relevant to the transaction that is the subject of management's assertions. Section 500 states that "in evaluating information to be used as audit evidence, the auditor should consider whether the results of audit procedures provide a basis for concluding on the sufficiency and appropriateness of audit evidence obtained."[19] Additionally, conclusions about hypothetical transactions may not contemplate all of the facts and circumstances or the provisions in the agreements of the transaction that is the subject of management's assertions, and generally would not provide persuasive evidence.[20]

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[18]Certain transferors are subject only to receivership (and not to proceedings under the U.S. Bankruptcy Code or the Federal Deposit Insurance Act) under laws that do not allow a receiver to reach assets in which a security interest has been granted. In such circumstances, an opinion that concludes that the transfer would either be a sale or a grant of a security interest that puts the transferred assets beyond the reach of such receiver and other creditors would provide persuasive evidence that the isolation criterion is met.

In certain circumstances, a legal specialist may provide an opinion on both steps of a two-step structure. Such language would be acceptable in an opinion for a transfer of assets in the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55 provided that the opinion on the transfer in the first step is consistent with paragraphs .13 or .14 of this interpretation. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[19]Paragraph .09 of section 500. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

.16 *Question* — Are legal opinions that restrict the use of the opinion to the client, or to third parties other than the auditor, acceptable audit evidence?

.17 *Interpretation* — No. In some cases, the auditor may decide it is necessary to contact the specialist to determine that the specialist is aware that his or her work will be used for evaluating the assertions in the financial statements.[21] Given the importance of the legal opinion to the assertion in this case, and the precision that legal specialists use in drafting such opinions, an auditor should not use as evidence a legal opinion that he or she deems otherwise adequate if the letter restricts use of the findings expressed therein to the client or to third parties other than the auditor. In that event, the auditor requests that the client obtain the legal specialist's written permission for the auditor to use the opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a).

.18 An example of a letter from a legal specialist to a client that adequately communicates permission for the auditor to use the legal specialist's opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) is as follows:

> Notwithstanding any language to the contrary in our opinions of even date with respect to certain bankruptcy issues relating to the previously referenced transaction, you are authorized to make available to your auditors such opinions solely as audit evidence in support of their evaluation of management's assertion that the transfer of the receivables meets the isolation criterion of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40-5(a), provided a copy of this letter is furnished to them in connection therewith. In authorizing you to make copies of such opinions available to your auditors for such purpose, we are not undertaking or assuming any duty or obligation to your auditors or establishing any lawyer-client relationship with them. Further, we do not undertake or assume any responsibility with respect to financial statements of you or your affiliates.[22]

.19 A letter from a legal specialist to a client might authorize the client to make copies of the legal opinion available to the auditor to use in his or her evaluation of management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) but then state that the auditor is not authorized to rely thereon. Such "use but not rely on" language, or other language that similarly restricts the auditor's use of the

[20]For example, a memorandum of law from a legal specialist usually analyzes (and may make conclusions about) a transaction that may be completed subsequently. Such memorandum generally would not provide persuasive evidence unless the conclusions conform with this interpretation and a legal specialist opines that such conclusions apply to a completed transaction that is the subject of management's assertion. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[21]Paragraph .A74 of section 501. [Footnote revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142.]

[22]This language may appear in the legal specialist's opinion rather than in a separate letter. In that case, the wording would be modified slightly to indicate the context. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

legal specialist's opinion, does not adequately communicate permission for the auditor to use the legal specialist's opinion as audit evidence. The auditor may consider consulting with his or her legal counsel in circumstances in which it is not clear that the auditor may use the legal specialist's opinion.

.20 *Question* — If the auditor determines that it is appropriate to use the work of a legal specialist, and either the resulting legal response does not provide persuasive evidence that a transfer of assets has met the isolation criterion or the legal specialist does not grant permission for the auditor to use a legal opinion that is restricted to the client or to third parties other than the auditor, what other steps might an auditor consider?

.21 *Interpretation* — When other relevant audit evidence exists, the auditor should consider it before reaching a conclusion about the appropriateness of management's accounting for a transfer.[23] However, because the isolation aspect of surrender of control is assessed primarily from a legal perspective, the auditor usually will not be able to obtain persuasive evidence in a form other than a legal opinion. In the absence of persuasive evidence that a transfer has met the isolation criterion, derecognition of the transferred assets is not in conformity with generally accepted accounting principles and the auditor may need to express a qualified or adverse opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.[24] However, if permission for the auditor to use a legal opinion that he or she deems otherwise adequate is not granted, this would be a scope limitation and the auditor should consider the need to express a qualified opinion or to disclaim an opinion in accordance with section 705.[25]

[Issue Date: December 2001; Revised: March 2006; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012; Revised: December 2022.]

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[23]See paragraph .13 of section 620, *Using the Work of an Auditor's Specialist*, regarding additional procedures that may be applied. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[24]Paragraphs .07–.09 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[25]Paragraphs .11–.14 of section 705.

AU-C Sections 700–799

AUDIT CONCLUSIONS AND REPORTING

AU-C Section 700

Forming an Opinion and Reporting on Financial Statements

(Supersedes SAS No. 122 section 700; SAS No. 131.)

Source: SAS No. 134; SAS No. 137; SAS No. 138; SAS No. 141; SAS No. 143.

Effective for audits of financial statements for periods ending on or after December 15, 2021, unless otherwise indicated.

Note
In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to form an opinion on the financial statements. It also addresses the form and content of the auditor's report issued as a result of an audit of financial statements.

.02 This section applies to an audit of a complete set of general purpose financial statements and is written in that context.

.03 This section is not applicable when the auditor is forming an opinion and reporting on financial statements of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). In such circumstances, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* applies.

.04 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) or includes an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report.

.05 This section does not require the communication of key audit matters. Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

.06 Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses special considerations when financial statements are prepared in accordance with a special purpose framework.[1]Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement. (Ref: par. .A1–.A2)

.07 The requirements of this section promote consistency and comparability in auditor reporting. Consistency in the auditor's report, when the audit has been conducted in accordance with generally accepted auditing standards (GAAS), promotes credibility in the marketplace by making more readily identifiable those audits that have been conducted in accordance with recognized standards. Consistency also helps promote users' understanding and identification of unusual circumstances when they occur.

Effective Date

.08 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.09 The objectives of the auditor are to do the following:

a. Form an opinion on the financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements or comparative financial information.

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[1]See section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, for a definition of *special purpose framework*.

b. Express clearly the opinion on the financial statements through a written report. (Ref: par. .A3)

Definitions

.10 For purposes of GAAS, the following terms have the meanings attributed as follows:

Comparative financial statements. A complete set of financial statements[2] for one or more prior periods included for comparison with the financial statements of the current period.

Comparative information. 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.

Condensed financial statements. Historical financial information[3] that is presented in less detail than a complete set of financial statements, in accordance with an appropriate financial reporting framework. Condensed financial statements may be separately presented as unaudited financial information or may be presented as comparative information.

General purpose financial statements. Financial statements prepared in accordance with a general purpose framework. (Ref: par. .A4)

General purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users.

Unmodified opinion. The opinion expressed by the auditor when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.[4]

.11 Reference to *financial statements* in this section means a complete set of general purpose financial statements. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

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[2]See section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for a definition of *financial statements*.

[3]Paragraph .14 of section 200 defines the term *historical financial information*.

[4]Paragraph .14 of section 200 defines the term *applicable financial reporting framework*.

Requirements

Forming an Opinion on the Financial Statements

.12 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. (Ref: par. .A5)

.13 In order to form that opinion, the auditor should conclude whether the auditor has obtained reasonable assurance[5] about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion should take into account the following: (Ref: par. .A6)

a. The auditor's conclusion, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, about whether sufficient appropriate audit evidence has been obtained[6]

b. The auditor's conclusion, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*, about whether uncorrected misstatements are material, individually or in the aggregate[7]

c. The evaluations required by paragraphs .14–.17

.14 The auditor should evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation should include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: par. .A7–.A9)

.15 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

a. the financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity and whether they have been presented in an understandable manner. (Ref: par. .A10)

b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.

c. the accounting estimates and related disclosures made by management are reasonable.

d. the information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should

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[5] Paragraph .14 of section 200 defines the term *reasonable assurance*.

[6] Paragraph .28 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[7] Paragraph .11 of section 450, *Evaluation of Misstatements Identified during the Audit*.

consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented. (Ref: par. .A11)

e. 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. (Ref: par. .A12)

f. the terminology used in the financial statements, including the title of each financial statement, is appropriate.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.16 The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following: (Ref: par. .A13–.A15)

a. The overall presentation, structure, and content of the financial statements

b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A16)

.17 The auditor should evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A17–.A20)

Form of Opinion

.18 The auditor should express an unmodified opinion when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.19 The auditor should modify the opinion in the auditor's report, in accordance with section 705, in the following circumstances:

a. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated.

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

.20 If the auditor concludes that the financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705. (Ref: par. .A21–.A22)

Auditor's Report

.21 The auditor's report should be in writing. (Ref: par. .A23–.A24)

Auditor's Report for Audits Conducted in Accordance With GAAS

Title

.22 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A25)

Addressee

.23 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A26)

Auditor's Opinion

.24 The first section of the auditor's report should include the auditor's opinion and should have the heading "Opinion."

.25 The "Opinion" section of the auditor's report should also do the following: (Ref: par. .A27–.A29)

a. Identify the entity whose financial statements have been audited.

b. State that the financial statements have been audited.

c. Identify the title of each statement that the financial statements comprise.

d. Refer to the notes.

e. Specify the dates of or periods covered by each financial statement that the financial statements comprise.

.26 When expressing an unmodified opinion on financial statements, the auditor's opinion should state that, in the auditor's opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. (Ref: par. .A17 and .A30–.A33)

.27 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A34)

Basis for Opinion

.28 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion," that does the following: (Ref: par. .A35)

a. States that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (Ref: par. .A36–.A37)

b. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS

c. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A38–.A39)

d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

Going Concern

.29 When applicable, the auditor should report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Key Audit Matters

.30 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A40)

Responsibilities of Management for the Financial Statements

.31 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.32 This section of the auditor's report should describe management's responsibility for the following:

a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for 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 (Ref: par. .A41)

b. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework*, as applicable].

.33 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A42)

Auditor's Responsibilities for the Audit of the Financial Statements

.34 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.35 This section of the auditor's report should do the following: (Ref: par. .A43)

a. State that the objectives of the auditor are to

  i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (Ref: par. .A44)

  ii. issue an auditor's report that includes the auditor's opinion.

b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A45)

c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[8] (Ref: par. .A46)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.36 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

a. Exercise professional judgment and maintain professional skepticism throughout the audit.

b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, no such opinion is expressed.

   In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, no such opinion is expressed."

d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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[8]Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit.*

e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

.37 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that the auditor identified during the audit.

Other Information

.38 When applicable, the auditor should report in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Other Reporting Responsibilities

.39 If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A47–.A48) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.40 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of paragraphs .22–.37 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A49) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Signature of the Auditor

.41 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A50–.A52) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Address

.42 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A53) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Date of the Auditor's Report

.43 The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence of the following: (Ref: par. .A54)

a. All the statements and disclosures that the financial statements comprise have been prepared.

b. Management has asserted that it has taken responsibility for those financial statements. (Ref: par. .A55–.A57)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards

.44 Paragraph .28 requires that the auditor's report state that the audit was conducted in accordance with GAAS and identify the United States of America as the country of origin of those standards. However, an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing [ISAs] or Government Auditing Standards). The auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. (Ref: par. .A58) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.45 When the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as its origin.

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

.46 When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS. (Ref: par. .A59–.A65) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Comparative Financial Statements and Comparative Information

.47 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the auditor's report should refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: par. .A66–.A67) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.48 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. (Ref: par. .A68–.A69) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.49 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. (Ref: par. .A70–.A71) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.50 If comparative information is presented and the entity requests the auditor to express an opinion on all periods presented, the auditor should consider whether the information included for the prior periods contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework. (Ref: par. .A72) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Procedures

.51 The auditor should perform the procedures required by paragraphs .52–.54 if comparative financial statements or comparative information is presented for the prior periods. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.52 The auditor should determine whether the comparative financial statements or comparative information has been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.53 The auditor should evaluate the following:

a. Whether the comparative financial statements or comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle

b. Whether the accounting policies reflected in the comparative financial statements or comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed[9]

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.54 If the auditor becomes aware of a possible material misstatement in the comparative financial statements or comparative information while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period's financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the relevant requirements of section 560, *Subsequent Events and*

[9]See section 708, *Consistency of Financial Statements*.

Subsequently Discovered Facts. If the prior period financial statements are restated, the auditor should determine that the comparative financial statements or comparative information agrees with the restated financial statements. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.55 As required by section 580, *Written Representations*, the auditor should request written representations for all periods referred to in the auditor's opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements. (Ref: par. .A73) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.56 When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706:

a. The date of the auditor's previous report

b. The type of opinion previously expressed

c. The substantive reasons for the different opinion

d. That the auditor's opinion on the amended financial statements is different from the auditor's previous opinion (Ref: par. .A74)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Prior Period Financial Statements Audited by a Predecessor Auditor

.57 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued,[10] in addition to expressing an opinion on the current period's financial statements, the auditor should state the following in an other-matter paragraph:[11]

a. That the financial statements of the prior period were audited by a predecessor auditor

b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore

c. The nature of an emphasis-of-matter paragraph, other-matter paragraph, or a going concern section included in the predecessor auditor's report, if any

d. The date of that report

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

[10] Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[11] See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

.58 If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor should follow the communication requirements in section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.[12] If the prior period financial statements are restated, and the predecessor auditor agrees to issue a new auditor's report on the restated financial statements of the prior period, the auditor should express an opinion only on the current period. (Ref: par. .A75) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Prior Period Financial Statements Not Audited

.59 When current period financial statements are audited and presented in comparative form with financial statements for the prior period for which a compilation or review was performed, and the report on the prior period is not reissued, the auditor should include an other-matter paragraph[13] in the current period auditor's report that includes the following with respect to the prior period:

a. The service performed in the prior period

b. The date of the report on that service

c. A description of any material modifications noted in that report

d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A76)

e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A77)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.60 If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (Ref: par. .A78) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Information Presented in the Financial Statements

.61 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. (Ref: par. .A79–.A80) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

[12] Paragraphs .12–.13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

[13] See section 706.

Application and Other Explanatory Material

Scope of This Section (Ref par. .06)

.A1 Section 800 also addresses the auditor's responsibilities when the auditor is reporting on financial statements prepared in accordance with a special purpose framework and is required by law or regulation to use a specific layout, form, or wording of the auditor's report. When reporting on financial statements prepared in accordance with a general purpose framework, and law or regulation requires a specific layout, form, or wording of the auditor's report, the auditor may adapt and apply the requirements in section 800.

.A2 Other AU-C sections that also contain reporting requirements include, but are not limited to, the following:

- Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- Section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Section 730, *Required Supplementary Information*
- Section 810, *Engagements to Report on Summary Financial Statements*
- Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Objectives

Considerations Specific to Governmental Entities (Ref: par. .09)

.A3 For audits of governmental entities, the objectives of a financial statement audit are often broader than forming and expressing an opinion on the financial statements. Paragraph .A47 discusses the auditor's other reporting responsibilities.

Definitions

General Purpose Financial Statements

Considerations Specific to Governmental Entities (Ref: par. .10)

.A4 For audits of governmental entities, the term *general purpose financial statements*, in the context of this section, would be considered or referred to as basic financial statements using the terms in the governmental entity's applicable financial reporting framework.

Forming an Opinion on the Financial Statements (Ref: par. .12)

.A5 As described in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, a financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

Considerations Specific to Governmental Entities (Ref: par. .13)

.A6 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units and, therefore, requires the presentation of financial statements for the governmental entity's activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. In the context of this section, the auditor is responsible for forming an opinion on the financial statements for each opinion unit within a governmental entity.

Qualitative Aspects of the Entity's Accounting Practices (Ref: par. .14)

.A7 Management makes a number of judgments about the amounts and disclosures in the financial statements.

.A8 Section 260, *The Auditor's Communication With Those Charged With Governance*, contains a discussion of the qualitative aspects of accounting practices.[14] In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's 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)

[14]The appendix "Qualitative Aspects of Accounting Practices" of section 260, *The Auditor's Communication With Those Charged With Governance*.

- Possible management bias in the making of accounting estimates

.A9 Section 540, *Auditing Accounting Estimates and Related Disclosures*, addresses possible management bias in making accounting estimates. Indicators of possible management bias, themselves, do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Accounting Policies Appropriately Disclosed in the Financial Statements (Ref: par. .15a)

.A10 In evaluating whether the financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include matters such as the following:

- Whether the financial statements include all disclosures related to the significant accounting policies that are required by the applicable financial reporting framework
- Whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement, and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances, and disclosures in the financial statements in the particular circumstances of the entity's operations and its environment
- The clarity with which the significant accounting policies have been presented

Information Presented in the Financial Statements Is Relevant, Reliable, Comparable, and Understandable (Ref: par. .15d)

.A11 Evaluating the understandability of the financial statements may include consideration of whether the information in the financial statements is presented in a manner that facilitates users' ability to identify necessary information. This may include whether the disclosures are appropriately labeled and cross-referenced.

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: par. .15e)

.A12 It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, results of operations, and cash flows. Evaluating whether, in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, results of operations, and cash flows may include consideration of such matters as the following:

- The extent to which the information in the financial statements is relevant and specific to the circumstances of the entity

- Whether the disclosures are adequate to assist the intended users in understanding the following:
  — The nature and extent of the entity's assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework
  — The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses

Evaluating Whether the Financial Statements Achieve Fair Presentation (Ref: par. .16)

.A13 Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. As noted in section 200, a *fair presentation financial reporting framework*[15] not only requires compliance with the requirements of the framework but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.

.A14 The auditor's evaluation about whether the financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the entity, including changes thereto, based on the auditor's understanding of the entity and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if there is a substantial likelihood that, individually, or in the aggregate, they would influence the judgement made by a reasonable user based on the financial statements.[16] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A15 Evaluating whether the financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example, the following:

- The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information or results in misleading information
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted

.A16 The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework.

[15] Paragraph .14 of section 200.

[16] See section 320.

Without that framework, the auditor would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements.

Description of the Applicable Financial Reporting Framework (Ref: par. .17)

.A17 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.[17] That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

.A18 The description may indicate that the financial statements have been prepared in accordance with that framework. Such a statement is appropriate only when the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

.A19 Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

.A20 The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework. Such information may not be required by the applicable financial reporting framework but may be presented as part of the basic financial statements. As discussed in paragraph .61, such information is considered an integral part of the financial statements if it cannot be clearly differentiated and, accordingly, is covered by the auditor's opinion.

Form of Opinion (Ref: par. .20)

.A21 In some instances, the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. When this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in unusual circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements, which would be extremely rare.

.A22 The "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct states the following:

> A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that

[17] Paragraphs .A2–.A3 of section 200.

he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Auditor's Report (Ref: par. .21)

.A23 A written report encompasses reports issued in hard copy format and those using an electronic medium.

.A24 The exhibit "Illustrations of Auditor's Reports on Financial Statements" contains illustrations of auditor's reports on financial statements incorporating the elements required by paragraphs .22–.43. With the exception of the "Opinion" and "Basis for Opinion" sections, this section does not establish requirements for ordering the elements of the auditor's report. However, this section requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with GAAS more recognizable, particularly in situations in which the elements of the auditor's report are presented in an order that differs from the illustrative auditor's reports in the exhibit to this section.

Auditor's Report for Audits Conducted in Accordance With GAAS

Title (Ref: par. .22)

.A25 Section 200 provides guidance on reporting when the auditor is not independent.[18]

Addressee (Ref: par. .23)

.A26 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. A report on the financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not to those charged with governance of the entity whose financial statements are being audited.

[18] Paragraph .A18 of section 200.

Auditor's Opinion (Ref: par. .25–.27)

.A27 The auditor's report states, for example, that the auditor has "audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements." If the financial statements include a separate statement of changes in stockholders' equity accounts or a separate statement of comprehensive income, paragraph .25*c* requires such statements to be identified in the "Opinion" section, but they need not be referred to separately in the opinion paragraph because changes in stockholders' equity accounts and comprehensive income are considered part of the presentation of financial position, results of operations, and cash flows.

.A28 The identification of the title and the dates of, or periods covered by, each statement that the financial statements comprise may also be achieved by referencing the table of contents in a document bound with or accompanying the financial statements and auditor's report thereon.

.A29 When the auditor is aware that the audited financial statements will be included in a document that contains information in addition to the financial statements and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users identify the financial statements to which the auditor's report relates.

.A30 When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion because these suggest a conditional opinion or a weakening or modification of the opinion.

.A31 The auditor's opinion covers the complete set of financial statements, as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the financial statements include a balance sheet, an income statement, a statement of changes in equity, and a cash flow statement, including related notes. In some circumstances, additional or different statements, schedules, or information also might be considered an integral part of the financial statements.

.A32 The reports in the exhibit "Illustrations of Auditor's Reports on Financial Statements" include example wording that may be used to replace the [...] based on the applicable financial reporting framework.

.A33 The title of the financial statements identified in the "Opinion" section (see paragraph .25*c*) describes the information that is the subject of the auditor's opinion.

.A34 *Description of the applicable financial reporting framework and how it may affect the auditor's opinion (Ref: par. .27).* The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph .16. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United

States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB) or *International Financial Reporting Standard for Small- and Medium-Sized Entities* promulgated by the IASB.

Basis for Opinion (Ref: par. .28)

.A35 The "Basis for Opinion" section provides important context about the auditor's opinion. Accordingly, this section requires the "Basis for Opinion" section to directly follow the "Opinion" section in the auditor's report.

.A36 The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards. For example, the auditor's report may refer to auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards.

.A37 In accordance with section 200, the auditor does not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of section 200 and all other AU-C sections relevant to the audit.[19]

.A38 *Relevant Ethical Requirements (Ref: par. .28c).*Section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.[20] When the AICPA Code of Professional Conduct applies, the auditor's other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, "Principles of Professional Conduct").

.A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. Section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,[21] provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

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[19] Paragraph .22 of section 200.

[20] Paragraph .A15 of section 200.

[21] Paragraphs .22–.23 of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

Key Audit Matters (Ref. par. .30)

.A40 Section 210, *Terms of Engagement*, requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.[22]

Responsibilities of Management for the Financial Statements (Ref: par. .31–.33)

.A41 Section 200 explains the premise relating to the responsibilities of management and, when appropriate, those charged with governance on which an audit in accordance with GAAS is conducted.[23] Management and, when appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for 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. The description of management's responsibilities in the auditor's report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. Section 260 uses the term *those charged with governance* to describe the persons or organizations with responsibility for overseeing the entity, and provides a discussion about the diversity of governance structures among entities.

.A42 In some instances, a document containing the auditor's report may include a separate statement by management or those charged with governance regarding their responsibility for the preparation of the financial statements. Any elaboration in the auditor's report about the responsibilities of management or those charged with governance regarding the preparation of the financial statements, or reference to a separate statement by management or those charged with governance about such responsibilities if one is included in a document containing the auditor's report, may lead users to erroneously believe that the auditor is providing assurances about representations made by management or those charged with governance about their responsibility for financial reporting, internal control, and other matters that might be discussed in the management report.

Auditor's Responsibilities for the Audit of the Financial Statements (Ref: par. .34–.37)

.A43 The description of the auditor's responsibilities as required by paragraphs .34–.37 of this section may be tailored to reflect the specific nature of the entity, for example, when the auditor's report addresses consolidated financial statements.

.A44 *Objectives of the Auditor (Ref: par. .35*a–c*)*. The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion. These objectives are in contrast to management's responsibilities for the preparation and fair presentation of the financial statements.

[22]Paragraph .10 of section 210, *Terms of Engagement*.

[23]Paragraphs .05 and .A2 of section 200.

.A45 Because the auditor's opinion is based on obtaining reasonable assurance, the auditor's report does not constitute a guarantee. Because of the inherent limitation of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS.[24]

.A46 When the applicable financial reporting framework defines materiality differently from the definition in section 320, *Materiality in Planning and Performing an Audit*, the auditor's report may need to reflect the definition or description of materiality from the applicable financial reporting framework.

Other Reporting Responsibilities (Ref: par. .39–.40)

.A47 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .39 will vary depending on the nature of the auditor's other reporting responsibilities. For example, for audits conducted under *Government Auditing Standards*, the auditor may be required to report on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements, which may be included in the "Other Reporting Responsibilities" section of the auditor's report.[25] However, when the auditor is engaged or required by law or regulation to perform a compliance audit in accordance with GAAS, *Government Auditing Standards*, and a governmental audit requirement, reporting requirements in section 935, *Compliance Audits*, apply.

.A48 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A49 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Signature of the Auditor (Ref: par. .41)

.A50 In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report.

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[24]Paragraph .A56 of section 200 and paragraph .10*d* of section 210.

[25]See AICPA Audit and Accounting Guide Government Auditing Standards *and Single Audits* for illustrative auditor reports.

.A51 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm.

.A52 *Considerations specific to governmental entities.* This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor's report when, in certain situations, the governmental auditor is required by law or regulation or chooses to do so.

Auditor's Address (Ref: par. .42)

.A53 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date of the Auditor's Report (Ref. par. .43)

.A54 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[26] When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.[27]

.A55 The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in section 560.

.A56 Because the auditor's opinion is provided on the financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that the financial statements comprise have been prepared, and management has accepted responsibility for them.

Considerations Specific to Governmental Entities

.A57 In some circumstances, final approval of the financial statements by governmental legislative bodies (or subsets of such legislative bodies) is required before the financial statements are issued. In these circumstances, final approval by such legislative bodies (or subsets of such legislative bodies) is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements, for purposes of GAAS, is the earlier date on which those with the recognized authority determine that all the statements and disclosures that the financial

[26]See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

[27]Paragraph .21 of section 220A.

statements comprise have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards (Ref: par. .43)

.A58 If the audit is performed in accordance with both GAAS and the ISAs, the auditor may find it helpful to refer to appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards." This appendix summarizes substantive differences between the ISAs and GAAS to assist the auditor in planning and performing an engagement in accordance with the ISAs.

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB (Ref: par. .46)

.A59 Auditors of financial statements of entities whose audits are within the jurisdiction of the PCAOB, which include issuers (as defined by the SEC) and nonissuer brokers and dealers registered with the SEC, are required to be registered with, and subject to inspection by, the PCAOB. In such circumstances, the AICPA Code of Professional Conduct requires AICPA members to conduct the audit in accordance with the standards of the PCAOB, and the audit is not required to also be conducted in accordance with GAAS.[28]

.A60 As discussed in paragraph .46, because the auditor is required to also conduct the audit in accordance with GAAS, it would be inappropriate for the auditor to issue a report that refers only to the standards of the PCAOB without also referring to GAAS.

.A61 When the auditor follows the standards of the PCAOB regarding the form of the auditor's report, PCAOB reporting requirements for specific circumstances, such as reporting on an integrated audit or supplementary information, may also be applicable.

.A62 The form of the auditor's report required by the standards of the PCAOB states that the audit was conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)." A reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules; whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" indicates compliance with only the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.[29]

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[28]See the "Compliance With Standards Rule" (ET sec. 1.310.001) and appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct.

.A63 Examples of situations in which an auditor may be engaged to conduct an audit in accordance with the standards (or auditing standards) of the PCAOB for an entity whose audit is not within the jurisdiction of the PCAOB include audits for clearing agencies and futures commission merchants registered with the U.S. Commodities Futures Trading Commission (CFTC), as well as other entities registered with the CFTC; audits of financial statements included in certain securities offering documents pursuant to Regulation A of the Securities Act of 1933; and circumstances in which a nonissuer company desires, or is required by contractual agreement, to obtain an audit of its financial statements in accordance with the standards of the PCAOB.

.A64 When an audit is being conducted in accordance with the standards of the PCAOB, the auditor would follow the relevant requirements in the PCAOB standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by paragraph .46 of this section.

.A65 The exhibit "Illustrations of Auditor's Reports on Financial Statements" contains an example of an auditor's report for the situation described in paragraph .46.

Comparative Financial Statements and Comparative Information (Ref: par. .47–.48)

.A66 The level of information included for the prior periods in comparative financial statements is comparable with that of the financial statements of the current period.

.A67 Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented.

Updating the Report

.A68 An updated report on prior period financial statements is distinguished from a reissuance of a previous report.[30] When issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

Other Considerations Relating to Comparative Financial Statements

.A69 If one firm of independent auditors merges with another firm, and the new firm becomes the auditor of a former client of one of the two former firms, the new firm may

[29]See Staff Question and Answer, *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board* (PCAOB Staff Guidance, sec. 100.01), dated June 30, 2004, in *PCAOB Standards and Related Rules*.

[30]See section 560, *Subsequent Events and Subsequently Discovered Facts*.

accept responsibility and express an opinion on the financial statements for the prior periods, as well as on those for the current period. In such circumstances, paragraphs .47–.60 apply. The new firm may indicate in the auditor's report or as part of the signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior period financial statements, the guidance for the reissuance of reports in section 560 would apply.

Comparative Information (Ref: par. .49–.50)

.A70 Comparative information, which may be condensed financial statements or prior period summarized financial information, is not considered comparative financial statements because it is not a complete set of financial statements. For example, entities such as state and local governmental units frequently present total-all-funds information for the prior periods rather than information by individual funds because of space limitations or to avoid cumbersome or confusing formats. Also, not-for-profit organizations frequently present certain summarized financial information for the prior periods in total rather than by net asset class. Accordingly, the auditor need not opine on comparative information in accordance with this section.

.A71 Paragraph .49 requires the auditor to clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking in the auditor's report when comparative information is presented but not covered by the auditor's opinion on the financial statements of the current period. The requirements and guidance in section 930, *Interim Financial Information*, may be adapted to report on condensed financial statements or prior period summarized financial information that is derived from audited financial statements and is presented comparatively with the complete set of financial statements of the current period.[31,32] The exhibit to this section provides examples of auditor's reports when comparative summarized financial information for the prior period is presented.[33]

.A72 If an entity requests the auditor to express an opinion on all periods presented, and comparative information is presented for one or more prior periods, in most cases, this will necessitate including additional columns or separate detail by fund or net asset class, or the auditor may need to modify the auditor's opinion, as required by section 705.

Written Representations (Ref: par. .55)

.A73 In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate.

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[31]Paragraph .33 of section 930, *Interim Financial Information*.

[32]See the AICPA Audit and Accounting Guides *State and Local Governments* and *Not-for-Profit Entities* for further guidance on reporting on summarized comparative financial information.

[33]Illustration 5, "An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year is Presented," of the exhibit "Illustrations of Auditor's Reports on Financial Statements."

*Opinion on Prior Period Financial Statements Different From Previous Opinion (Ref: **par. .56**)*

.A74 When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if, during the course of the audit of the current period, the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.[34]

*Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: **par. .58**)*

.A75 The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements that have been restated. In this situation, provided that the auditor has audited the adjustments to the prior period financial statements, the auditor may include an other-matter paragraph[35] in the auditor's report indicating that the predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the auditor is engaged to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of the restatement, the auditor's report may also include the following within the other-matter paragraph:

> As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the Company other than with respect to the adjustments, and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements as a whole.

*Prior Period Financial Statements Not Audited (Ref: **par. .59–.60**)*

.A76 The following is an example of an other-matter paragraph when a review was performed on the prior period financial statements:

> *Other Matter*
>
> The 20X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 20X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in accordance with accounting principles generally accepted in the United States of America. A review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements as a whole.

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[34] See section 560.

[35] See section 706.

.A77 The following is an example of an other-matter paragraph when a compilation was performed on the prior period financial statements:

> *Other Matter*
>
> We (other accountants) performed a compilation engagement with respect to the 20X1 financial statements and our (their) report thereon, dated March 1, 20X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

.A78 If the prior period financial statements were not audited, reviewed, or compiled, the following is an example of an other-matter paragraph:

> *Other Matter*
>
> The accompanying balance sheet of X Company as of December 31, 20X1, and the related statements of income and cash flows for the year then ended were not audited, reviewed, or compiled by us, and, accordingly, we do not express an opinion or any other form of assurance on them.

Information Presented in the Financial Statements (Ref: par. .61)

.A79 In some circumstances, the entity may be required by law, regulation, or standards, or may voluntarily choose, to include in the basic financial statements information that is not required by the applicable financial reporting framework. The auditor's opinion covers information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented.

.A80 If the information included in the basic financial statements is not required by the applicable financial reporting framework and is not necessary for fair presentation but is clearly differentiated, then such information may be identified as "unaudited" or as "not covered by the auditor's report."

Exhibit — Illustrations of Auditor's Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)

.A81

Illustration 1 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters

Illustration 3 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 4 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Illustration 5 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented

Illustration 6 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented

Illustration 7 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board

Illustration 8 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board

Illustration 1— An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[1]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and

[1]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[2] In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 2 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[3]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and

[3] The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[*Description of each key audit matter in accordance with section 701,* Communicating Key Audit Matters in the Independent Auditor's Report]

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[4]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[4]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[5]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results

[5]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[6]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[6] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The financial statements are audited in accordance with auditing standards generally accepted in the United States of America and International Standards on Auditing (ISAs).[7]
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement,* and ISA 210, *Agreeing the Terms of Audit Engagements*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.

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[7]Paragraph 50 of International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, allows the auditor to use the layout or wording of the national auditing standards (in this case, GAAS), provided that (1) there are no conflicts between the requirements in GAAS and the ISAs that would lead to a different conclusion with respect to the opinion, and (2) the layout or wording addresses, and is not inconsistent with, certain of the required minimum reporting elements in ISA 700 (Revised).

- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[8]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of ABC Company, and have fulfilled our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits, which include relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management and Those Charged With Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

[8] The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*]; to disclose, as applicable, matters related to going concern; and to use the going concern basis of accounting unless management either intends to liquidate ABC Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing ABC Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and ISAs will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and ISAs, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[9]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

[9] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the ABC Company to express an opinion on the financial statements. We are responsible for the direction, supervision, and performance of the group audit of ABC Company. We remain solely responsible for our audit opinion.[10]

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[10] This has been included to comply with paragraph 50(k) of ISA 700 (Revised).

Illustration 5 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Prior year summarized comparative financial information derived from audited financial statements is presented.
- Management is responsible for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[11]

Opinion

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related

[11]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.[12]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

Report on Summarized Comparative Information

We have previously audited XYZ Not-for-Profit Organization's 20X0 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 15, 20X0. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 20X0, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*Cityand state where the auditor's report is issued*]

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[12]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

[*Date of the auditor's report*]

Illustration 6 — An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Prior year summarized comparative financial information derived from unaudited financial statements is presented.
- Management is responsible for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[13]

Opinion

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related

[13]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.[14]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

Report on Summarized Comparative Information

The summarized comparative information presented herein as of and for the year ended September 30, 20X0, derived from those unaudited financial statements, has not been audited, reviewed, or compiled, and, accordingly, we express no opinion on it.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports *(see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

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[14] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

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Illustration 7 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended. The audit is not a group audit.
- The firm is registered with the PCAOB and for purposes of this engagement is required by regulation to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Report of Independent Registered Public Accounting Firm

[*To the Shareholders and the Board of Directors of X Company*][15]

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial

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[15]See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in *PCAOB Standards and Related Rules*. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

> AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan; (2) the directors (or equivalent) and equity owners for a broker or dealer; and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

All AS sections can be found in *PCAOB Standards and Related Rules*.

position of the Company as of [*at*] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.[16]

Critical Audit Matters (if Applicable)

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[16]As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor's report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

> We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.
>
> Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee[17] and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[*Include critical audit matters*]

[*Signature*]

We have served as the Company's auditor since [*year*].[18]

[*City and State or Country*]

[*Date*]

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[17] AS 1301, *Communications with Audit Committees*, defines "audit committee" as

> A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.
>
> For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

[18] As discussed in Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The sample auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

Illustration 8 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended.
- The firm is not registered with the PCAOB and for purposes of this engagement is not required to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Report of Independent Public Accounting Firm

[*To the Shareholders and the Board of Directors of X Company*][19]

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of [*at*] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31,

[19]See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in *PCAOB Standards and Related Rules*. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

> AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan, (2) the directors (or equivalent) and equity owners for a broker or dealer, and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

20X2, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.[20]

Critical Audit Matters (if applicable)

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated

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[20]As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor's report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

> We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting.
>
> Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

to the audit committee[21] and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[*Include critical audit matters*]

[*Signature*]

We have served as the Company's auditor since [*year*].[22]

[*City and State or Country*]

[*Date*]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. Revised, January 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138. Revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

[21]AS 1301, *Communications with Audit Committees,* defines "audit committee" as

> A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.
>
> For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

[22]As discussed in Staff Guidance *Changes To The Auditor's Report Effective For Audits of Fiscal Years Ending On or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The example auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

AU-C Section 9700

Forming an Opinion and Reporting on Financial Statements: Auditing Interpretations of Section 700

1. Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting

.01 *Question* — An entity prepares its financial statements using the liquidation basis of accounting in accordance with FASB *Accounting Standards Codification* (ASC) 205, *Presentation of Financial Statements*, because the entity is either in liquidation or liquidation is imminent. Is the auditor permitted to issue an unmodified opinion on such financial statements?

.02 *Interpretation* — Yes. A liquidation basis of accounting is considered generally accepted accounting principles (GAAP) for entities in liquidation or for which liquidation is imminent. Therefore, the auditor is permitted to issue an unmodified opinion on such financial statements, provided that the liquidation basis of accounting has been properly applied and that adequate disclosures are made in the financial statements in accordance with FASB ASC 205-30.

.03 Typically, the financial statements of entities using the liquidation basis of accounting are presented along with financial statements of a period prior to adoption of a liquidation basis that were prepared on the going concern basis in accordance with GAAP. Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, requires the auditor to include an emphasis-of-matter paragraph when a matter that is appropriately presented or disclosed in the financial statements is of such importance, in the auditor's professional judgment, that it is fundamental to users' understanding of the financial statements. If the auditor determines an emphasis-of-matter paragraph is appropriate, the emphasis-of-matter paragraph would state that the entity has changed the basis of accounting used to determine the amounts at which assets and liabilities are carried from the going concern basis to a liquidation basis.

.04 Two examples of auditor's reports with such an emphasis-of-matter paragraph follow.

Example 1— Report on the Audit of Single-Year Financial Statements in Year of Adoption of Liquidation Basis

Independent Auditor's Report

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of XYZ Company, which comprise the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets in liquidation of XYZ Company as of December 31, 20X2, the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the results of its operations and its cash flows for the period from January 1, 20X2 to April 25, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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 Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.[1] Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

[1]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control. Accordingly, no such opinion is expressed."

Example 2 — Report on the Audit of Comparative Financial Statements in Year of Adoption of Liquidation Basis

Independent Auditor's Report

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X1, the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Company as of December 31, 20X1, the results of its operations and its cash flows for the year then ended and for the period from January 1, 20X2 to April 25, 20X2, its net assets in liquidation as of December 31, 20X2, and the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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 Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.[2] Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

[2]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control. Accordingly, no such opinion is expressed."

.05 The auditor may, in subsequent years, continue to include an emphasis-of-matter paragraph in the auditor's report to emphasize that the financial statements are presented on a liquidation basis of accounting.

[Issue Date: December 1984; Revised: June 1993; Revised: February 1997; Revised: October 2000; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012; Revised: May 2014; Revised: September 2014; Revised: March 2020.]

2. Sustainability Financial Statements Under Federal Financial Accounting Standards — Auditor Reporting

.06 *Question* — The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) No. 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. SFFAS No. 36, as amended, requires that the statement of long-term fiscal projections be presented in the consolidated financial report of the U.S. government as a basic financial statement starting in fiscal year 2015. The focus of this standard is on forward-looking information intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statement of long-term fiscal projections presents the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid. The statement of long-term fiscal projections includes information drawn from the current statement of social insurance (SFFAS No. 17, *Accounting for Social Insurance*, as amended, a basic statement since fiscal year 2006) and statement of changes in social insurance amounts (SFFAS No. 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*, a basic statement since fiscal year 2011). Collectively, the statement of long-term fiscal projections, the statement of social insurance, and the statement of changes in social insurance amounts are referred to herein as sustainability financial statements. May an auditor report on these basic financial statements in accordance with auditing standards generally accepted in the United States of America (GAAS)? If so, how would an auditor report on these statements?

.07 *Interpretation* — Yes, consistent with Statement of Position 04-1, *Auditing the Statement of Social Insurance* (AUD sec. 35), an auditor may report on the basic financial statements, which include the statements of social insurance, changes in social insurance amounts, and long-term fiscal projections, in accordance with GAAS. Section 700, *Forming an Opinion and Reporting on Financial Statements*, provides requirements and guidance on forming an opinion on the basic financial statements. An illustration of an auditor's report containing an unmodified opinion on the U.S. government-wide financial statements follows[3] (footnotes are provided for necessary adjustments when reporting on component financial statements containing sustainability financial statements):

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[3]The sustainability financial statements do not articulate with the consolidated financial statements. For that reason, the opinion on the sustainability financial statements ordinarily will not affect the opinion on the consolidated financial statements. For example, the opinion on the sustainability financial statements may be modified, whereas the opinion on the consolidated financial statements may be unmodified.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements

Opinions on the Financial Statements

We have audited the financial statements of *the U.S. government*,[4] which comprise the consolidated financial statements and the sustainability financial statements. The consolidated financial statements comprise the *consolidated balance sheets as of September 30, 20XX and 20YY, and the related consolidated statements of net cost, of operations and changes in net position, reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*[5] for the years then ended, and the related notes to the consolidated financial statements.

The sustainability financial statements comprise the statements of social insurance as of [*dates — five years presented*], the statements of changes in social insurance amounts for the periods [*dates — two periods presented*]*, and the statements of long-term fiscal projections as of September 30, 20XX and 20YY*, and the related notes to the sustainability financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, *the financial position of the U.S. government as of September 30, 20XX and 20YY, and its net cost, operations, and changes in net position; reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*[6] for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Also, in our opinion, the sustainability financial statements referred to above present fairly, in all material respects, the *U.S. government's social insurance information as of* [*dates — five years presented*], its changes in social insurance amounts for the periods [*dates — two periods presented*], *and the long-term fiscal projections as of September 30, 20XX and 20YY*, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

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[4]Italicized text would be applicable only to reports on the consolidated financial statements of the U.S. government. Where appropriate, alternative text applicable to reports on component entity financial statements are provided in other footnotes.

[5]For reports on component entity financial statements, the financial statements would be tailored to the financial statements presented, for example "...the balance sheets as of September 30, 20XX and 20YY and the related statements of net cost, *(and)* changes in net position, *(and custodial activity),* and combined statements of budgetary resources...".

[6]For reports on component entity financial statements, this language would be tailored to the financial statements presented, for example "... the financial position of [*name of entity*] as of September 30, 20XX and 20YY, and its net cost, changes in net position, *(and)* and budgetary resources *(, and custodial activity)*...."

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States [*include Office of Management and Budget (OMB) Bulletin No. and title, if applicable*]. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the U.S. government, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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 Responsibilities for the Audit of the Financial Statements

Our objectives under GAAS and *Government Auditing Standards* are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* [*include OMB Bulletin, if applicable*] will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the U.S. Government's internal control. Accordingly, no such opinion is expressed.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about U.S. Government's ability to continue as a going concern for a reasonable period of time.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

Emphasis of Matter

As discussed in Note X to the financial statements, the sustainability financial statements are based on management's assumptions. These sustainability financial statements present the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid using a projection period sufficient to illustrate long-term sustainability. The sustainability financial statements are intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statements of social insurance and changes in social insurance amounts are based on income and benefit formulas in current law and assume that scheduled benefits will continue after any related trust funds are exhausted. *The statements of long-term fiscal projections are based on the continuation of current policy.* The sustainability financial statements are not forecasts or predictions. The sustainability financial statements are not intended to imply that current policy or law is sustainable. In preparing the sustainability financial statements, management considers and selects assumptions and data that it believes provide a reasonable basis to illustrate whether current policy or law is sustainable. Assumptions underlying such sustainability information do not consider changes in policy or all potential future events that could affect future income, future expenditures, and sustainability, for example, implementation of policy changes to avoid trust fund exhaustion *or unsustainable debt levels*. Because of the large number of factors that affect the sustainability financial statements and the fact that future events and circumstances cannot be estimated with certainty, even if current policy is continued, there will be differences between the estimates in the sustainability financial statements and the actual results, and those differences may be material. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information in the Management's Discussion and Analysis and Required Supplementary Information (RSI) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated [*date of report*] on our consideration of the *U.S. government's* internal control over financial reporting and our report dated [*report date*] on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the *U.S. government's* internal control over financial reporting and compliance.

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

[Issue Date: October 2015; Revised: March 2020.]

3. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

[.08–.13] [Withdrawn March 2020 due to the issuance of SAS No. 134, as amended.]

Introduction

On June 1, 2017, the PCAOB adopted AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.[7] The SEC approved AS 3101 and related amendments on October 23, 2017. AS 3101 retains the pass or fail opinion of the existing PCAOB auditor's report but makes significant changes to the existing PCAOB auditor's report, including the following:

- Requiring communication of critical audit matters (CAMs). Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that

— relates to accounts or disclosures that are material to the financial statements and

— involved especially challenging, subjective, or complex auditor judgment

- Requiring disclosure of auditor tenure. The year in which the auditor began serving consecutively as the company's auditor
- Other improvements to the auditor's report. Clarification of the auditor's role and responsibilities, such as a statement regarding the requirement for the auditor to be independent with respect to the company, and making the auditor's report easier to read

Among the other revisions, AS 3101 specifies the form of the report, including requirements related to the order of presentation and section titles. All the changes, except those relating to CAMs, are effective for audits of fiscal years ending on or after December 15, 2017.[8]

As noted in PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*,

> There are situations in which an auditor may be required by law or regulation, or voluntarily agrees, to perform an audit engagement in accordance with PCAOB standards for a company whose audit is not subject to PCAOB oversight.[112] For example, SEC rules permit audits under PCAOB standards in connection with offerings under Regulation A and Regulation Crowdfunding. In these situations, certain elements of the auditor's report required under the final standard, such as the use of "registered public

[7]All PCAOB auditing standards can be found in *PCAOB Standards and Related Rules*.

[8]PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, was issued June 1, 2017, and was approved by the SEC on October 23, 2017. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance, sec. 300.04) (updated as of December 28, 2017), was prepared by PCAOB staff to help firms when implementing changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017.

accounting firm" in the title or the statement regarding independence requirements, may not apply.

[112] Under the Sarbanes-Oxley Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the PCAOB oversees the audits of "issuers" and brokers and dealers reporting under Exchange Act Rule 17a-5. See Sarbanes-Oxley Act Section 101. An "issuer" under the Sarbanes-Oxley Act is an entity whose securities are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a Securities Act registration statement that has not yet become effective and that it has not withdrawn. See Sarbanes-Oxley Section 2(a).

GAAS currently address the appropriate form of report when an auditor issues a report referencing both GAAS and the standards of the PCAOB. Section 700, *Forming an Opinion and Reporting on Financial Statements*,[9] states

When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002 (the Act), as amended, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS.

Interpretation No. 4, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (par. .14–.21), provides guidance on how an auditor complies with section 700[10] in the context of the revised reporting standards adopted by the PCAOB and approved by the SEC. Because of the phased approach of the effective dates of AS 3101, Interpretation No. 4 does not address the changes relating to CAMs.

Interpretation No. 5, “Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB” (par. .22–.26), provides guidance on how an auditor complies with section 700 in the context of the PCAOB reporting standards when the communication of CAMs is required.

Although Interpretation No. 4 and Interpretation No. 5 have been determined to be consistent with GAAS, the interpretations should not be construed to be interpretations of PCAOB standards. Moreover, Interpretation No. 4 and Interpretation No. 5 have not been approved or acted upon by the PCAOB.

[9]Paragraph .46 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

[10]See footnote 9.

4. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB

.14 *Question* — Section 700[11] states, in part, that the auditor should use the form of report required by the standards of the PCAOB. Are there any elements of the auditor's report required by the standards of the PCAOB whose presentation may need to be revised in order to comply with the PCAOB reporting requirements?

.15 *Interpretation* — Yes. To appropriately apply the requirement in section 700[12] to follow the PCAOB form of the report, the auditor will need to evaluate the circumstances of the engagement and also may need to modify the report as described in the following paragraphs to avoid making an untrue statement.

.16 *Question* — Paragraph .06 of AS 3101 states that the auditor "must include the title, 'Report of Independent Registered Public Accounting Firm'" and the related description in the "Basis for Opinion" section of the report required by paragraph .09*g* of AS 3101. Is it appropriate for an auditor to revise the report by removing the references to "registered" if the firm is not registered with the PCAOB?

.17 *Interpretation* — Yes, removing the reference to "registered" from the title and from the "Basis for Opinion" section of the report is appropriate if the firm is not registered with the PCAOB. As noted in Staff Questions and Answers *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board*,[13] dated June 30, 2004, a public accounting firm does not need to be registered with the PCAOB to perform an audit of a nonissuer in accordance with PCAOB standards.

.18 *Question* — How should the auditor address the requirement in paragraph .09*g* of AS 3101 that notes that the auditor "is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB"?

.19 *Interpretation* — Generally, GAAS do not require the auditor to be independent under SEC and PCAOB standards unless required by law or regulation. Therefore, it would be appropriate in those circumstances for the auditor to revise the statement in the report regarding independence to reflect the circumstances of the engagement. For example, if the auditor is not required to be independent under U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB, this statement may be amended to read, "We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audit."[14]Section 200,

[11]See footnote 9.

[12]See footnote 9.

[13]PCAOB Staff Guidance, sec. 100.01.

[14]See illustration 8, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States

Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards, explains that relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.[15] Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. Depending on the circumstances, for example, when independence and ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (such as the AICPA Code of Professional Conduct) or rule or applicable regulation or may refer to a term that appropriately describes those sources.

.20 In addition, the auditor may need to revise the reference to "the standards" of the PCAOB as described in section 700.[16] As noted in section 700,[17] reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules, whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" is limited to compliance with the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.

.21 The exhibit to section 700[18] contains examples of auditor's reports on comparative financial statements when the audits are conducted in accordance with both GAAS and either the standards of the PCAOB or the auditing standards of the PCAOB.

[Issue Date: March 2018; Revised: March 2020.]

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of America and the Auditing Standards of the Public Company Accounting Oversight Board," in the exhibit to section 700.

[15] Paragraph .A15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[16] Paragraph .A62 of section 700.

[17] See footnote 10 and paragraph .A62.

[18] See illustration 7, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board," and illustration 8.

5. Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB

.22 *Question* — When reporting on audits of nonissuer entities that are not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended, but conducted in accordance with the standards of the PCAOB and GAAS, is the auditor required to communicate critical audit matters (CAMs) in accordance with paragraphs .11–.17 of AS 3101?

.23 *Interpretation* — Section 700[19] states that the auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. Section 700[20] also states that "…when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS."

.24 Accordingly, the auditor would follow the relevant requirements in the PCAOB standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by section 700.[21]

.25 Note that paragraph .05*b* of AS 3101 lists entities for which communication of CAMs is not required, including brokers and dealers, investment companies registered under the Investment Company Act of 1940, employee stock purchases, savings and similar plans, and emerging growth companies. Whether a nonissuer is such an entity is a matter for management to determine, and may involve consultation with management's legal counsel, based on the entity's circumstances.

.26 Accordingly, an auditor should apply all the requirements for CAMs set forth in AS 3101 unless it is determined by management that the entity is not subject to CAM reporting as described previously.

[Issue Date: October 2019; Revised: March 2020.]

[19]Paragraph .44 of section 700.

[20]Paragraph .46 of section 700.

[21]Paragraph .28 of section 700.

AU-C Section 701

Communicating Key Audit Matters in the Independent Auditor's Report

Source: SAS No. 134; SAS No. 141; SAS No. 143; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so. It is intended to address both the auditor's judgment about what to communicate in the auditor's report and the form and content of such communication. This section does not require the communication of key audit matters. (Ref: par. .A1)

.02 The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed. The communication of key audit matters in the auditor's report may also provide intended users of the financial statements (intended users) with a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed. (Ref: par. .A2–.A3)

.03 Communicating key audit matters in the auditor's report is done in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report does *not* constitute the following:

a. A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation

b. A substitute for the auditor expressing a modified opinion when required to do so by the circumstances of a specific audit engagement in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*

c. A substitute for reporting in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, if, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains

d. A separate opinion on individual matters (Ref: par. .A4–.A6)

.04 This section applies to an audit of a complete set of general purpose financial statements when the auditor is engaged to communicate key audit matters. Section 705 prohibits the auditor from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.[1]

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.06 The objectives of the auditor are to determine key audit matters and communicate those matters by describing them in the auditor's report.

Definition

.07 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

[1]Paragraph .30 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Key audit matters. Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Requirements

Determining Key Audit Matters

.08 The auditor should determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor should take into account the following: (Ref: par. .A7–.A16)

a. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Ref: par. .A17–.A20)

b. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that are subject to a high degree of uncertainty (Ref: par. .A21–.A22)

c. The effect on the audit of significant events or transactions that occurred during the period (Ref: par. .A23–.A24)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.09 The auditor should determine which of the matters determined in accordance with paragraph .08 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Ref: par. .A7–.A9, .A25–.A30)

Communicating Key Audit Matters

.10 The auditor should describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs .13–.14 apply. The introductory language in this section of the auditor's report should state the following:

a. Key audit matters are those matters that were communicated with those charged with governance and, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.

b. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: par. .A31–.A33)

Key Audit Matters Not a Substitute for Expressing a Modified Opinion

.11 The auditor should not communicate a matter in the "Key Audit Matters" section of the auditor's report when the auditor would be required to modify the opinion in accordance with section 705 as a result of the matter. (Ref: par. .A4)

Descriptions of Individual Key Audit Matters

.12 The description of each key audit matter in the "Key Audit Matters" section of the auditor's report should include a reference to the related disclosures, if any, in the financial statements and should address the following: (Ref: par. .A34–.A41)

a. Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter (Ref: par. .A42–.A44)

b. How the matter was addressed in the audit (Ref: par. .A45–.A50)

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report

.13 The auditor should describe each key audit matter in the auditor's report unless either of the following applies:

a. Law or regulation precludes disclosure about the matter. (Ref: par. .A51)

b. In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This does not apply if information about the matter is available outside the entity. (Ref: par. .A52–.A55)

Interaction Between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report

.14 Matters giving rise to a qualified opinion in accordance with section 705, or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, are by their nature key audit matters. However, these matters should not be described in the "Key Audit Matters" section of the auditor's report, and the requirements in paragraphs .12–.13 do not apply. Rather, the auditor should do the following:

a. Report on these matters in accordance with the applicable AU-C sections.

b. Include a reference to the "Basis for Qualified Opinion" or "Going Concern" section in the "Key Audit Matters" section. (Ref: par. .A5)

Form and Content of the "Key Audit Matters" Section in Other Circumstances

.15 If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph .14, the auditor should include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters." (Ref: par. .A56–.A57)

Communication With Those Charged With Governance

.16 The auditor should communicate the following with those charged with governance:

a. Those matters the auditor has determined to be the key audit matters, or

b. If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report (Ref: par. .A58–.A61)

Documentation

.17 The auditor should include the following in the audit documentation:[2] (Ref: par. .A62)

a. The matters that required significant auditor attention as determined in accordance with paragraph .08, and the rationale for the auditor's determination about whether or not each of the matters is a key audit matter in accordance with paragraph .09

b. When applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph .14

c. When applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Paragraph .45 and related application material in section 700, *Forming an Opinion and Reporting on Financial Statements*, address reporting on audits conducted in accordance with the standards of the PCAOB and GAAS when the audit is not within the jurisdiction of the PCAOB.

.A2 Communicating key audit matters provides additional information to intended users to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

.A3 Section 320, *Materiality in Planning and Performing an Audit*, explains that the auditor may assume the following regarding reasonable users of the financial statements:[3]

[2]Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

a. Users have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence.

b. Users understand that the financial statements are prepared, presented, and audited to levels of materiality.

c. Users recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events.

d. Users make reasonable judgments based on the information in the financial statements.

Because the auditor's report accompanies the audited financial statements, the users of the auditor's report are considered to be the same as the intended users of the financial statements.

[Revised, April 2021, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

Relationship Between Key Audit Matters, the Auditor's Opinion, and Other Elements of the Auditor's Report (Ref: par. .03, .11, .14)

.A4 Sections 700 and 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, establish requirements and provide guidance on forming an opinion on the financial statements.[4] Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation. Section 705 addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.[5]

.A5 When the auditor expresses a qualified opinion in accordance with section 705, communicating key audit matters would still be relevant to enhancing intended users' understanding of the audit. In these circumstances, presenting the description of the matter giving rise to a qualified opinion in the "Basis for Qualified Opinion" section gives the matter the appropriate prominence in the auditor's report (see paragraph .14) and separates the communication of this matter from any other key audit matters described in the "Key Audit Matters" section. The exhibit in section 705 includes illustrative examples of how the introductory language in the "Key Audit Matters" section is affected when the auditor expresses a qualified opinion and other key audit matters are communicated in the auditor's report. Paragraph .A57 of this section illustrates how the "Key Audit Matters" section is presented when the auditor has determined that there are no other key audit matters to be

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[3]Paragraph .04 of section 320, *Materiality in Planning and Performing an Audit*.

[4]Paragraphs .12–.17 and .A5–.A20 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraphs .37–.42 and .A61–.A74 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

[5]Paragraph .A7 of section 705.

communicated in the auditor's report beyond matters addressed in the "Basis for Qualified Opinion" or "Going Concern" sections of the auditor's report.

.A6 Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, establishes mechanisms for auditors of financial statements of all entities to include additional communication in the auditor's report through the use of emphasis-of-matter paragraphs and other-matter paragraphs when the auditor considers it necessary to do so. However, when this section applies, the use of an emphasis-of-matter or other-matter paragraph is not a substitute for including a matter in the "Key Audit Matters" section of the auditor's report if the matter meets the definition of a key audit matter. Section 706 provides further guidance on the relationship between key audit matters and emphasis-of-matter and other-matter paragraphs.[6]

Determining Key Audit Matters (Ref: par. .08–.09)

.A7 The auditor's decision-making process in determining key audit matters begins with selecting, from among the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit of the financial statements of the current period.

.A8 From the matters that required significant auditor attention, the auditor then determines those matters that, in the auditor's judgment, were of most significance in the audit of the financial statements of the current period and that, therefore, are the key audit matters. The auditor's determination of key audit matters is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented (that is, even when the auditor's opinion refers to each period for which financial statements are presented).

.A9 This section does not require the auditor to update key audit matters included in the prior period's auditor's report. However, it may nevertheless be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial statements of the prior period continues to be a key audit matter in the audit of the financial statements of the current period.

Matters That Required Significant Auditor Attention (Ref: par. .08)

.A10 The concept of significant auditor attention recognizes that an audit is risk based and focuses on identifying and assessing the risks of material misstatement of the financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof.

[6]Paragraphs .A1–.A2 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

.A11 Accordingly, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on the financial statements may be particularly relevant in the auditor's determination of key audit matters.

.A12 Areas of significant auditor attention often relate to areas of complexity and significant management judgment in the financial statements and therefore often involve difficult or complex auditor judgments. In turn, this often affects the auditor's overall audit strategy, the allocation of resources, and the extent of audit effort in relation to such matters. These effects may include, for example, the extent of involvement of senior personnel on the audit engagement or the involvement of an auditor's expert or individuals with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm to address these areas.

.A13 Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.[7] For example, there may be potential difficulties relating to the following:

   i. *Related party transactions.* In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.[8]

   ii. *Limitations on the group audit.* For example, the group engagement team's access to information may be restricted.[9]

b. Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.[10] For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.

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[7]Paragraphs .12*b* and .A26 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[8]Paragraph .A46 of section 550, *Related Parties*.

[9]Paragraph .49*d* of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

[10]Paragraph .20 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Considerations in Determining Those Matters That Required Significant Auditor Attention (Ref: par. .08)

.A14 The auditor may develop a preliminary view at the planning stage about matters that are likely to be areas of significant auditor attention in the audit and therefore may be key audit matters. The auditor may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with section 260. However, the auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.

.A15 Paragraph .08 includes specific required considerations in the auditor's determination of those matters that required significant auditor attention. These considerations focus on the nature of matters communicated with those charged with governance that are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit in accordance with paragraph .09. Because the considerations may be interrelated (for example, matters relating to the circumstances described in paragraphs .08*b–c* may also be identified as significant risks), the applicability of more than one of the considerations to a particular matter communicated with those charged with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.

.A16 In addition to matters that relate to the specific required considerations in paragraph .08, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph .09. Such matters may include, for example, matters that are relevant to the audit that was performed but that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, particularly if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (for example, changes to a system affecting revenue recognition).

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance With Section 315 (Ref: par. .08a)

.A17 Section 260 requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor.[11] Section 260 explains that the auditor may also communicate with those charged with governance about areas of higher assessed risks of material misstatement.[12]

.A18 SAS No. 145 defines a *significant risk* as an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of

[11] Paragraph .11 of section 260.

[12] Paragraph .A20 of section 260.

inherent risk due to the degree to which the inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.[13] Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A19 However, this may not be the case for all significant risks. For example, section 240, *Consideration of Fraud in a Financial Statement Audit*, presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.[14] In addition, section 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.[15] Depending on their nature, these risks may not require significant auditor attention and therefore would not be considered in the auditor's determination of key audit matters in accordance with paragraph .09.

.A20 Section 315 explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.[16] Revision to the auditor's risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements may result in an area being determined to be one requiring significant auditor attention, particularly when the revision results in a higher assessed risk of material misstatement. For example, the auditor's risk assessment may have been based on an expectation that certain controls were operating effectively, but the audit evidence obtained may indicate that such controls were not operating effectively throughout the audit period, leading to a change in audit strategy and additional audit effort.

Significant Auditor Judgments Relating to Areas in the Financial Statements That Involved Significant Management Judgment, Including Accounting Estimates That Are Subject to a High Degree of Estimation Uncertainty (Ref: par. .08b)

.A21 Section 260 requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.[17] In particular, this may include accounting policies that have a significant effect on the

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[13]See paragraph .13 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

[14]Paragraphs .26–.27 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[15]Paragraph .31 of section 240. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[16]Paragraph .32 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

[17]Paragraph .12*a* of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

financial statements (and significant changes to those policies), especially in circumstances in which an entity's accounting policies are not consistent with others in its industry.

.A22 In many cases, the auditor's communication with those charged with governance relates to accounting estimates and related disclosures. Among other things, estimates may be highly dependent on management judgment and are often the most complex areas of the financial statements, and the estimates may require the involvement of both a management's expert and an auditor's expert. Such estimates are often areas of significant auditor attention, and they may be identified as significant risks.

The Effect on the Audit of Significant Events or Transactions That Occurred During the Period (Ref: par. .08c)

.A23 Events or transactions that had a significant effect on the financial statements or the audit may be areas of significant auditor attention and may be identified as significant risks. For example, the auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial statements of significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.[18] Management may have made difficult or complex judgments in relation to recognition, measurement, presentation, or disclosure of such transactions, which may have had a significant effect on the auditor's overall strategy.

.A24 Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgments may also affect the auditor's overall approach to the audit and result in a matter requiring significant auditor attention.

Matters of Most Significance (Ref: par. .09)

.A25 The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the intent is for the auditor to identify matters specific to the audit and to make a judgment about their relative importance.

.A26 Matters that required significant auditor attention also may have resulted in significant interaction with those charged with governance. The nature and extent of communication about such matters with those charged with governance often provides an indication of which matters are of most significance in the audit. For example, the auditor may have had more in-depth, frequent, or robust interactions with those charged with governance on more difficult and complex matters, such as the application of significant accounting policies that were the subject of significant auditor or management judgment.

.A27 The importance of a matter to intended users' understanding of the financial statements as a whole and, in particular, the matter's materiality to the financial statements is relevant to determining whether the matter is a key audit matter.

[18]Paragraphs .12*a*, .14, and .A32 of section 260, and the appendix, "Qualitative Aspects of Accounting Practices," of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A28 Other considerations that may be relevant to determining the relative significance of a matter and whether such a matter is a key audit matter include the following:

- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry
- The nature and materiality, quantitative or qualitative, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any
- The nature and extent of audit effort needed to address the matter, including the following:
  - — The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any
  - — The nature of consultations outside the engagement team regarding the matter
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, particularly as the auditor's judgments become more subjective
- The severity of any control deficiencies identified that are relevant to the matter
- Whether the matter involved a number of separate, but related, auditing considerations (For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation, or other contingencies and may have an effect on other accounting estimates.)

.A29 Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements of the current period is a matter of professional judgment. The number of key audit matters to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of matters initially determined to be key audit matters, the more the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter. Lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

.A30 Paragraph .15 addresses the form and content of the "Key Audit Matters" section of the auditor's report when the auditor determines that there are no key audit matters to be communicated.

Communicating Key Audit Matters

Separate "Key Audit Matters" Section in the Auditor's Report (Ref: par. .10)

.A31 Placing the separate "Key Audit Matters" section in close proximity to the "Opinion" and "Basis for Opinion" sections may give prominence to such information.

.A32 The order of presentation of individual matters within the "Key Audit Matters" section is a matter of professional judgment. For example, such information may be organized in order of relative importance, may be based on the auditor's judgment, or may correspond to the manner in which matters are disclosed in the financial statements. The requirement in paragraph .10 to include subheadings is intended to further differentiate the matters.

.A33 When comparative financial information is presented, the introductory language of the "Key Audit Matters" section is tailored to draw attention to the fact that the key audit matters described relate to only the audit of the financial statements of the current period and may include reference to the specific period covered by those financial statements (for example, "for the year ended December 31, 20X1").

Descriptions of Individual Key Audit Matters (Ref: par. .12)

.A34 The adequacy of the description of a key audit matter is a matter of professional judgment. The description of a key audit matter is meant to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps enable intended users, who may not have a reasonable knowledge of auditing, to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor is intended to be balanced in the context of the responsibilities of the respective parties (that is, for the auditor to provide useful information in a concise and understandable form while not inappropriately being the provider of original information about the entity).

.A35 Original information is any information about the entity that has not otherwise been made publicly available by the entity (for example, the information has not been included in the financial statements or other information available at the date of the auditor's report and has not been addressed in other oral or written communications by management or those charged with governance). Such information is the responsibility of the entity's management and those charged with governance.

.A36 Although the auditor seeks to avoid providing original information about the entity, it may be necessary for the auditor to do so in the description of a key audit matter. Such information may be necessary to appropriately explain why the matter was considered to be one of most significance in the audit, and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation. When the auditor determines that it is necessary to include such information in the description of a key audit matter, management may elect to expand or supplement the entity's disclosures, rather than having the auditor provide original information in the auditor's report.

.A37 Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework. Additional disclosures by management may also be helpful when the auditor considers it necessary to include additional information to explain why a matter was determined to be a key audit matter and how the matter was addressed in the audit.

.A38 Although the auditor's opinion on the financial statements does not extend to the other information addressed by section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, the auditor may consider this information, as well as other publicly available communications by the entity or other credible sources, in formulating the description of a key audit matter. [Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

.A39 Audit documentation prepared during the audit can also be useful to the auditor in formulating the description of a key audit matter. For example, written communications, or the auditor's documentation of oral communications, with those charged with governance and other audit documentation provide a useful basis for the auditor's communication in the auditor's report. This is because audit documentation in accordance with section 230, *Audit Documentation*, is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, and serves as a record of the nature, timing, and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matters and may also assist in applying the requirement in paragraph .17.

Reference to Where the Matter Is Disclosed in the Financial Statements (Ref: par. .12)

.A40 Paragraph .12 requires the description of each key audit matter to address why the auditor considered the matter to be one of most significance in the audit and how the matter was addressed in the audit. Accordingly, the description of key audit matters is not a mere reiteration of what is disclosed in the financial statements. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.

.A41 In addition to referring to related disclosures, the auditor may draw attention to key aspects of them. The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor pinpoint particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter, such as in the following examples:

- When an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.

- When the auditor concludes, in accordance with section 570, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor's work effort under section 570 are key audit matters. In such circumstances, the auditor's description of such key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or noncompliance with loan agreements, and related mitigating factors.[19]

Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: par. .12a)

.A42 The description of a key audit matter in the auditor's report is intended to provide insight regarding why the matter was determined to be a key audit matter. Accordingly, the requirements in paragraphs .08–.09 and the application material in paragraphs .A10–.A28 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor's report. For example, explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.

.A43 Relating a matter directly to the specific circumstances of the entity may also help minimize the potential that such descriptions become overly standardized and less useful over time. For example, certain matters may be determined to be key audit matters in a particular industry across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered a matter to be one of most significance, it may be useful for the auditor to highlight aspects of the matter that are specific to the entity (for example, circumstances that affected the underlying judgments made in the financial statements of the current period) in order to make the description more relevant for intended users. This may also be important in describing a key audit matter that recurs over periods.

.A44 The description may also make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance. The following are examples of such considerations:

- Economic conditions that affected the auditor's ability to obtain audit evidence, for example, illiquid markets for certain financial instruments
- New or emerging accounting policies, for example, entity-specific or industry-specific matters on which the engagement team consulted
- Changes in the entity's strategy or business model that had a material effect on the financial statements

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[19]Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

How the Matter Was Addressed in the Audit (Ref: par. .12b)

.A45 The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgment. In accordance with paragraph .12*b*, the auditor may describe the following elements, or some combination thereof:

- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement
- A brief overview of procedures performed
- An indication of the outcome of the auditor's procedures
- Key observations with respect to the matter

Law or regulation may prescribe a specific form or content for the description of a key audit matter or may specify the inclusion of one or more of these elements.

.A46 In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial statements as a whole, as well as the relationship between key audit matters and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a key audit matter does the following:

- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements
- Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language
- Takes into account how the matter is addressed in the related disclosures in the financial statements, if any
- Does not contain or imply discrete opinions on separate elements of the financial statements

.A47 Describing aspects of the auditor's response or approach to a matter, particularly when the audit approach required significant tailoring to the facts and circumstances of the entity, may assist intended users in understanding unusual circumstances and significant auditor judgments required to address the risk of material misstatement. In addition, the audit approach in a particular period may have been influenced by entity-specific circumstances, economic conditions, or industry developments. It may also be useful for the auditor to make reference to the nature and extent of communications with those charged with governance about the matter.

.A48 For example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may wish to highlight that the auditor employed or engaged an auditor's expert. Such a reference to the use of an auditor's expert does not reduce the auditor's responsibility for the opinion on the financial statements and is therefore not inconsistent with paragraphs .14–.15 of section 620, *Using the Work of an Auditor's Specialist*.

.A49 There may be challenges in describing the auditor's procedures, particularly in complex, judgmental areas of the audit. In particular, it may be difficult to summarize the procedures performed in a succinct way that adequately communicates the nature and extent of the auditor's response to the assessed risk of material misstatement and the significant auditor judgments involved. Nonetheless, the auditor may consider it necessary to describe certain procedures that were performed to explain how a matter was addressed in the audit. Such description may typically be at a high level, rather than a detailed description of all procedures performed regarding the matter; that is, the auditor may describe just those procedures that are most relevant to the unique facts and circumstances of the entity and the current period audit.

.A50 As noted in paragraph .A45, the auditor may also provide an indication of the outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that the description in any way may call into question the auditor's opinion on the financial statements as a whole.

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report (Ref: par. .13)

.A51 Law or regulation may preclude disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, disclosure about a matter related to a government contractor may be precluded due to the nature of the matter and security clearance provisions that may apply to the auditor.

.A52 As indicated by paragraph .13*b*, it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report. This is because there is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases in which the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating the matter.

.A53 The determination not to communicate a key audit matter takes into account the facts and circumstances related to the matter. Communication with management and those charged with governance helps the auditor understand management's views about the significance of the adverse consequences that may arise as a result of communicating a matter. In particular, communication with management and those charged with governance helps inform the auditor's judgment in determining whether to communicate the matter in the following ways:

- Assisting the auditor in understanding why the matter has not been disclosed by the entity (for example, if law, regulation, or certain financial reporting frameworks permit delayed disclosure or nondisclosure of the matter) and understanding management's views regarding the adverse consequences, if any, of disclosure. Management may draw attention to certain aspects in law or regulation or other authoritative sources that may be relevant to the consideration of adverse consequences (for example, such consequences may include harm to the entity's commercial negotiations or competitive position). However, management's views about the adverse consequences alone do not alleviate the need for the auditor to determine whether the adverse consequences would reasonably be expected to outweigh the public interest benefits of communication in accordance with paragraph .13*b*.

- Highlighting whether there have been any communications with applicable regulatory, enforcement, or supervisory authorities in relation to the matter and, in particular, whether such discussions would appear to support management's assertion about why public disclosure about the matter is not appropriate.
- Enabling the auditor, when appropriate, to encourage management and those charged with governance to disclose relevant information about the matter. In particular, this may be possible if the concerns of management and those charged with governance about communicating the matter are limited to specific aspects of the matter, such that certain information about the matter may be less sensitive and could be communicated.

The auditor also may consider it necessary to obtain a written representation from management explaining why disclosure of the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

.A54 It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements. In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement, or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also help inform the auditor's consideration of the adverse consequences that may arise from communicating about the matter.

.A55 The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice.

*Form and Content of the "Key Audit Matters" Section in Other Circumstances (Ref: **par. .15**)*

.A56 The requirement in paragraph .15 applies in three circumstances:

- In the rare circumstance that the auditor determines, in accordance with paragraph .09, that there are no key audit matters. This may be the case because there were no matters that required significant auditor attention.

- The auditor determines, in accordance with paragraph .13, that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.
- The only matters determined to be key audit matters are those communicated in accordance with paragraph .14.

.A57 The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

Key Audit Matters

[*Except for the matter described in the Basis for Qualified Opinion section or Going Concern section*,] We have determined that there are no [*other*] key audit matters to communicate in our report.

Communication With Those Charged With Governance (Ref: par. .16)

.A58 Section 260 requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications with those charged with governance about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

.A59 Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report and provides them with an opportunity to obtain further clarification when necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognizes their important role in overseeing the financial reporting process and provides them the opportunity to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

.A60 The communication with those charged with governance required by paragraph .16*a* also addresses the extremely rare circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report (see paragraphs .13 and .A53).

.A61 The requirement in paragraph .16*b* to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

Documentation (Ref: par. .17)

.A62 Paragraph .08 of section 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments. In the context of key audit matters, these professional judgments include the determination, from the matters communicated with those charged with governance, of the matters that required significant auditor attention and whether or not each of those matters is a key audit matter. The auditor's judgments in this regard are likely to be supported by the documentation of the auditor's communications with those charged with governance and the audit documentation relating to each individual matter (see paragraph .A39), as well as by certain other audit documentation of the significant matters arising during the audit (for example, a completion memorandum). However, this section does not require the auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.

AU-C Section 703

Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

Source: SAS No. 136; SAS No. 138; SAS No. 140; SAS No. 141; SAS No. 143; SAS No. 145.

Effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021. Exhibit B provides transitional implementation reporting guidance upon initial implementation by the auditor of this section.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to form an opinion on the financial statements of employee benefit plans (EBPs) subject to the Employee Retirement Income Security Act of 1974 (ERISA), hereinafter referred to as ERISA plans. It also addresses the form and content of the auditor's report issued as a result of an audit of ERISA plan financial statements. This section applies to audits of single employer, multiple employer, and multiemployer plans subject to ERISA. This section should not be adapted for plans that are not subject to ERISA. (Ref: par. .A1)

.02 This section applies to an audit of a complete set of general purpose financial statements of EBPs subject to ERISA and is written in that context.

.03 The Department of Labor (DOL), IRS, and the Pension Benefit Guaranty Corporation (PBGC) jointly developed the Form 5500 series so EBPs could use the Form 5500 series forms to satisfy annual reporting requirements under Title I and Title IV of ERISA and the IRC. The Form 5500 series is part of ERISA's overall reporting and disclosure framework, which is intended to assure that EBPs are operated and managed in accordance with certain prescribed standards and that participants and beneficiaries, as well as regulators, are provided or have access to sufficient information to protect the rights and benefits of participants and beneficiaries under EBPs. The Form 5500 series includes Form 5500, *Annual Return/Report for Employee Benefit Plan, and related schedules* (hereinafter referred to as *Form 5500*). (Ref: par. .A2–.A5)

.04 ERISA requires that certain supplemental schedules accompany the ERISA plan financial statements (hereinafter referred to as *ERISA-required supplemental schedules*), if applicable. Paragraphs .127–.135 address the auditor's responsibilities relating to reporting on the ERISA-required supplemental schedules, and paragraphs .22–.24 address the auditor's responsibilities relating to prohibited transactions.

.05 The requirements in this section are specific to ERISA plan audit engagements and are intended to be performed as part of the audit of ERISA plan financial statements in accordance with generally accepted auditing standards (GAAS); however, this section does not contain all the requirements necessary to form an opinion and report on ERISA plan financial statements.

.06 When performing an audit of ERISA plan financial statements, all AU-C sections apply, except for the following sections or portions thereof, which are not applicable to an audit of ERISA plan financial statements because those requirements and related application material are specifically covered in this section:

a. Section 700, *Forming an Opinion and Reporting on Financial Statements*

b. Paragraph .09 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*

In addition, this section contains incremental requirements to section 210A, *Terms of Engagement*; section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*; section 260, *The Auditor's Communication With Those Charged With Governance*; and section 580, *Written Representations*.

.07 This section also addresses the auditor's responsibilities for forming an opinion on ERISA plan financial statements, including the form and content of the report when management elects to have an audit performed pursuant to ERISA Section 103(a)(3)(C) (hereinafter referred to as an *ERISA Section 103(a)(3)(C) audit)*.

.08 When management elects an ERISA Section 103(a)(3)(C) audit, as discussed in paragraph .07, the audit need not extend to any statements or information related to assets held for investment of the plan (hereinafter referred to as *investment information*) by a bank or similar institution or an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with the Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-5 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA (hereinafter referred to as a *qualified institution*). Paragraphs .29–.35 contain required procedures when an ERISA Section 103(a)(3)(C) audit is performed. (Ref: par. .A6–.A10)

.09 Reference to *ERISA plan financial statements* in this section means a complete set of general purpose financial statements[1] for an EBP subject to ERISA. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements. (Ref: par. .A11–.A12)

.10 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) or includes an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report. (Ref: par. .A13)

.11 This section does not require the communication of key audit matters. Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

.12 Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses special considerations when financial statements are prepared in accordance with a special purpose framework.[2]Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement. (Ref. par. .A14–.A15)

Effective Date

.13 This section is effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021. Exhibit B, "Implementation Guidance for ERISA Section 103(a)(3)(C) Audits," provides transitional implementation reporting guidance upon initial implementation by the auditor of this section. [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

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[1]See the AU-C Glossary for a definition of *general purpose financial statements*.

[2]See section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, for a definition of *special purpose framework*.

Objectives

.14 The objectives of the auditor are to do the following:

a. Accept an ERISA plan audit engagement when the basis upon which it is to be performed has been agreed upon through establishing whether the preconditions for the audit are present (Ref: par. .A5)

b. Appropriately plan and perform the audit of ERISA plan financial statements, including procedures required by this section on the certified investment information when management elects an ERISA Section 103(a)(3)(C) audit

c. Form an opinion on the ERISA plan financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements[3]

d. Express clearly the opinion on the ERISA plan financial statements through a written report

e. Perform procedures and report on the presentation of the supplementary information in accordance with this section

f. Appropriately communicate to management and those charged with governance reportable findings that the auditor has identified during the audit of the ERISA plan financial statements

Requirements

Engagement Acceptance

.15 In addition to the preconditions for an audit in section 210A, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility for the following: (Ref: par. .A16)

a. Maintaining a current plan instrument, including all plan amendments (Ref: par. .A22)

b. Administering the plan and determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants to determine the benefits due or which may become due to such participants (Ref: par. .A60)

c. When management elects to have an ERISA Section 103(a)(3)(C) audit, determining whether

    i. an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances,

[3]See the AU-C Glossary for a definition of *comparative financial statements*.

ii. the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8,

iii. the certification meets the requirements in 29 CFR 2520.103-5, and

iv. the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework

.16 When management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor should inquire of management about how management determined that the entity preparing and certifying the investment information is a qualified institution, as discussed in paragraphs .08 and .A6.

.17 The auditor should also obtain the agreement of management or those charged with governance to provide to the auditor, prior to the dating of the auditor's report, a draft of Form 5500 that is substantially complete (hereinafter referred to as the *draft Form 5500*). (Ref: par. .A17)

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements

.18 SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, the applicable financial reporting framework, and its internal control. The plan instrument is essential to understanding the plan and identifying and performing audit procedures that are responsive to assessed risks. (Ref: par. .A18–.A21) [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.19 The auditor should obtain and read the most current plan instrument for the audit period, including effective amendments (hereinafter referred to as the *plan instrument*), as part of obtaining an understanding of the entity sufficient to perform risk assessment procedures. (Ref: par. .A22–.A24)

.20 When designing and performing audit procedures, the auditor should consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for significant classes of transactions, account balances, and disclosures. (Ref: par. .A25–.A28) [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Plan Tax Status

.21 As part of the auditor's responsibilities in accordance with section 250 relating to the plan's tax status, the auditor should consider whether management has performed the relevant IRC compliance tests, including but not limited to, discrimination testing, and has corrected or intends to correct failures, as applicable. (Ref: par. .A29–.A32)

Prohibited Transactions

.22 The auditor should evaluate whether prohibited transactions identified by management or as part of the audit have been appropriately reported in the applicable ERISA-required supplemental schedules (see paragraph .A5). (Ref: par. .A33–.A35)

.23 If the auditor becomes aware that the plan has entered into a prohibited transaction with a party in interest, and the prohibited transaction has not been properly reported in the applicable ERISA-required supplemental schedule, the auditor should discuss the matter with management. If management does not revise the ERISA-required supplemental schedule, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedule is not revised, the auditor should modify the auditor's opinion on the ERISA-required supplemental schedule, when the effect of the transaction is material based on the financial statements as a whole. When the effect of the prohibited transaction is not material to the financial statements, then the auditor should include additional discussion in the other-matter paragraph in the auditor's report on the ERISA-required supplemental schedules describing the prohibited transaction. (Ref: par. .A36)

.24 If a material prohibited party-in-interest transaction that is not disclosed in the ERISA-required supplemental schedule is also considered a related party transaction and that transaction is not properly disclosed in the notes to the ERISA plan financial statements, the auditor should modify the auditor's opinion on the financial statements in accordance with section 705 due to a departure from the applicable financial reporting framework.

Evaluation and Documentation

.25 When the audit work performed results in the identification of items that are not in accordance with the criteria specified (for example, not in accordance with the plan instrument), the auditor should evaluate whether the matters are reportable findings. Reportable findings are matters that are one or more of the following:

a. An identified instance of noncompliance or suspected noncompliance with laws or regulations in accordance with section 250

b. A finding arising from the audit that is, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process in accordance with section 260

c. An indication of 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 in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*

.26 The auditor should prepare audit documentation in accordance with section 230, *Audit Documentation*. If the auditor has determined that it is not necessary to test any relevant plan provisions as described in paragraph .20, the auditor should document the considerations in reaching such conclusion. (Ref: par. .A37)

Communication With Management or Those Charged With Governance

.27 Based on the evaluation required by paragraph .25, the auditor should communicate in writing to those charged with governance, on a timely basis, reportable findings from the audit procedures performed relating to the matters included in paragraph .20. Such communication should be included with the required communication with those charged with governance in accordance with sections 250, 260, or 265, as appropriate, either in a separate section or placed in such communications as the auditor deems appropriate. The written communication should include the following:

a. A description of the reportable finding

b. Sufficient information to enable those charged with governance and management to understand the context of the communication

c. An explanation of the potential effects of the reportable findings on the financial statements or to the plan

(Ref: par. .A38–.A45)

.28 The auditor should not issue a written communication stating that no reportable findings were identified during the audit. (Ref: par. .A46)

Procedures for an ERISA Section 103(a)(3)(C) Audit

.29 When management elects to have an ERISA Section 103(a)(3)(C) audit as discussed in paragraph .08, the auditor should evaluate management's assessment of whether the entity issuing the certification is a qualified institution under DOL rules and regulations. (Ref: par. .A47–.A48)

.30 If, as a result of the procedures performed in paragraph .29, the auditor has concerns about whether the entity preparing and certifying the investment information is a qualified institution, the auditor should discuss his or her concerns with management. If management does not provide sufficient information that supports its determination that the entity preparing and certifying the investment information is a qualified institution, then the auditor should discuss his or her concerns with those charged with governance and determine the implications for the audit. (Ref: par. .A49)

.31 The auditor should identify which investment information is certified.

.32 The auditor should perform the following procedures on the certified investment information: (Ref: par. .A50)

a. Obtain from management and read the certification as it relates to investment information prepared and certified by a qualified institution (Ref: par. .A6–.A7 and .A50–.A52)

b. Compare the certified investment information with the related information presented and disclosed in the ERISA plan financial statements and ERISA-required supplemental schedules (Ref: par. .A53)

c. Read the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of the applicable financial reporting framework

.33 If, as part of the procedures performed in paragraphs .31–.32, the auditor becomes aware that the certified investment information in the financial statements and related disclosures is incomplete, inaccurate, or otherwise unsatisfactory, the auditor should discuss the matter with management and perform additional procedures to determine the appropriate course of action. (Ref: par. .A54–.A57)

.34 The auditor should perform audit procedures on the financial statement information, including the disclosures, not covered by the certification as well as noninvestment-related information based on the assessed risk of material misstatement. Plans may hold investments in which only a portion are covered by a certification by a qualified institution. In that case, the auditor should perform audit procedures on the investment information that has not been certified. (Ref: par. .A58)

.35 For all audits of ERISA plan financial statements, including an ERISA Section 103(a)(3)(C) audit, the auditor should perform the procedures necessary to become satisfied that received and disbursed amounts (for example, employer or employee contributions and benefit payments) reported by the trustee or custodian were determined in accordance with the plan provisions (also see paragraph .17).

Written Representations

.36 In addition to the requirements in section 580, the auditor should request the following written representations from management in an audit of ERISA plan financial statements: (Ref: par. .A59)

a. That management has provided the auditor with the most current plan instrument for the audit period, including all plan amendments

b. Acknowledgement of its responsibility for administering the plan and determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants to determine the benefits due or which may become due to such participants (Ref: par. .A60)

c. When management elects to have an ERISA Section 103(a)(3)(C) audit, acknowledgement that management's election of the ERISA Section 103(a)(3)(C) audit does not affect its responsibility for the financial statements and for determining whether

i. an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances,

ii. the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8,

iii. the certification meets the requirements in 29 CFR 2520.103-5, and

iv. the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework

Forming an Opinion on the ERISA Plan Financial Statements

.37 The auditor should form an opinion on whether the ERISA plan financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (Ref: par. .A61)

.38 In order to form that opinion, the auditor should conclude whether the auditor has obtained reasonable assurance[4] about whether the ERISA plan financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion should take into account the following:

a. The auditor's conclusion, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, about whether sufficient appropriate audit evidence has been obtained[5]

b. The auditor's conclusion, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*, about whether uncorrected misstatements are material, individually or in the aggregate[6]

c. The evaluations required by paragraphs .39–.42 of this section

.39 The auditor should evaluate whether the ERISA plan financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation should include consideration of the qualitative aspects of the plan's accounting practices, including indicators of possible bias in management's judgments. (Ref: par. .A62–.A64)

.40 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

a. the ERISA plan financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the plan and whether they have been presented in an understandable manner. (Ref: par. .A65)

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[4]Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines the term *reasonable assurance*.

[5]Paragraph .28 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

[6]Paragraph .11 of section 450, *Evaluation of Misstatements Identified During the Audit*.

b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.

c. the accounting estimates and related disclosures made by management are reasonable.

d. the information presented in the ERISA plan financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented; (Ref: par. .A66)

e. the ERISA plan 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 ERISA plan financial statements. (Ref: par. .A67)

f. the terminology used in the ERISA plan financial statements, including the title of each financial statement, is appropriate.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.41 The auditor's evaluation about whether the ERISA plan financial statements achieve fair presentation should also include consideration of the following: (Ref: par. .A68–.A70)

a. The overall presentation, structure, and content of the ERISA plan financial statements

b. Whether the ERISA plan financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A71)

.42 The auditor should evaluate whether the ERISA plan financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A72–.A75)

Form of Opinion

Auditor's Opinion on ERISA Plan Financial Statements

.43 The auditor should express an unmodified opinion[7] when the auditor concludes that the ERISA plan financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.44 The auditor should modify the opinion in the auditor's report, in accordance with section 705, in the following circumstances:

[7]See the AU-C Glossary for a definition of *unmodified opinion*.

a. The auditor concludes that, based on the audit evidence obtained, the ERISA plan financial statements as a whole are materially misstated.

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the ERISA plan financial statements as a whole are free from material misstatement.

Auditor's Opinion on ERISA Plan Financial Statements When Performing an ERISA Section 103(a)(3)(C) Audit

.45 When management elects an ERISA Section 103(a)(3)(C) audit, the auditor should follow the requirements in paragraphs .98–.126 of this section. (Ref: par. .A13)

Fair Presentation

.46 If the auditor concludes that the ERISA plan financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705. (Ref: par. .A76–.A77)

Considerations Relating to Form 5500 Filing

Reading the Draft Form 5500

.47 The auditor should make appropriate arrangements with management to obtain the draft Form 5500. The auditor should obtain and read the draft Form 5500 prior to dating the auditor's report. (Ref: par. .A78)

.48 The auditor should read the draft Form 5500 in order to identify material inconsistencies, if any, with the audited ERISA plan financial statements. (Ref: par. .A79–.A80)

.49 The auditor should communicate with those charged with governance the auditor's responsibility with respect to Form 5500, procedures performed relating to Form 5500, and the results of those procedures.

Material Inconsistencies With the Draft Form 5500

.50 If, on reading the draft Form 5500, the auditor identifies a material inconsistency, the auditor should determine whether the audited ERISA plan financial statements or the draft Form 5500 needs to be revised.

.51 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Date of the Auditor's Report That Require Revision of the Audited ERISA Plan Financial Statements.* When the auditor identifies a material inconsistency between the draft Form 5500 and the ERISA plan financial statements that requires revision of the audited ERISA plan financial statements prior to the date of the auditor's report, and management refuses to make the revision, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the revisions are not made, the auditor should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705.

.52 *Material Inconsistencies With the Draft Form 5500 Identified After the Date of the Auditor's Report But Prior to the Report Release Date That Require Revision of the Audited ERISA Plan Financial Statements.* When the auditor identifies a material inconsistency between the draft Form 5500 and the ERISA plan financial statements after the date of the auditor's report but prior to the report release date that requires revision of the audited ERISA plan financial statements, the auditor should apply the relevant requirements in section 560, *Subsequent Events and Subsequently Discovered Facts*.

.53 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Report Release Date That Require Revision of the Draft Form 5500.* When the auditor identifies a material inconsistency prior to the report release date that requires revision of the information in the draft Form 5500, and management refuses to make the revision, the auditor should communicate this matter to those charged with governance and (Ref: par. .A81)

a. include in the auditor's report an other-matter paragraph describing the material inconsistency, in accordance with section 706,

b. withhold the auditor's report, or

c. when withdrawal is possible under applicable law or regulation, withdraw from the engagement.

.54 *Material Inconsistencies Identified Subsequent to the Report Release Date.* When revision of the audited ERISA plan financial statements is necessary as a result of a material inconsistency with the information in Form 5500 and the auditor's report on the ERISA plan financial statements has already been released, the auditor should apply the relevant requirements in section 560.

.55 When revision of Form 5500 is necessary after the report release date and management agrees to make the revision, the auditor should carry out the procedures necessary under the circumstances. (Ref: par. .A82)

.56 When revision of Form 5500 is necessary after the report release date but management refuses to make the revision, the auditor should notify those charged with governance of the auditor's concerns regarding Form 5500 and take any further appropriate action. (Ref: par. .A83)

Material Misstatement of Fact

.57 If, on reading the draft Form 5500 for the purpose of identifying material inconsistencies between Form 5500 and the ERISA plan financial statements, the auditor becomes aware of an apparent material misstatement of fact in the draft Form 5500, the auditor should discuss the matter with management. (Ref: par. .A84)

.58 When, following such discussions as described in paragraph .57, the auditor still considers that there is an apparent material misstatement of fact, the auditor should request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor should consider the advice received by the entity in determining whether such matter is a material misstatement of fact.

.59 When the auditor concludes that there is a material misstatement of fact that management refuses to correct, the auditor should notify those charged with governance of the auditor's concerns regarding the information in the draft Form 5500 and take any further appropriate action. (Ref: par. .A85)

Auditor's Report on ERISA Plan Financial Statements (Other Than for an ERISA Section 103(a)(3)(C) Audit)[8]

.60 The auditor's report should be in writing. (Ref: par. .A86–.A87)

Title

.61 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A88)

Addressee

.62 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A89–.A90)

Auditor's Opinion

.63 The first section of the auditor's report should include the auditor's opinion and should have the heading "Opinion."

.64 The "Opinion" section of the auditor's report should also do the following: (Ref: par. .A91–.A93)

a. Identify the plan whose financial statements have been audited

b. State that the financial statements have been audited, and the plan is an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA),

c. Identify the title of each statement that the financial statements comprise

d. Refer to the notes

e. Specify the dates of or periods covered by each financial statement that the financial statements comprise

.65 When expressing an unmodified opinion on the ERISA plan financial statements, the auditor's opinion should state that, in the auditor's opinion, the accompanying financial

[8] For ERISA Section 103(a)(3)(C) audits, paragraphs .98–.126 apply instead of paragraphs .60–.82.

statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. (Ref: par. .A94–.A97)

.66 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A98)

Basis for Opinion

.67 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion" that does the following: (Ref: par. .A99)

a. States that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (Ref: par. .A100–.A101)

b. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS

c. Includes a statement that the auditor is required to be independent of the plan and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A102–.A103)

d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

Going Concern

.68 When applicable, the auditor should report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Key Audit Matters

.69 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A104)

Responsibilities of Management for the Financial Statements

.70 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.71 This section of the auditor's report should describe management's responsibility for the following:

a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for 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. (Ref: par. .A105–.A106)

b. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework, as applicable*.]

c. Maintaining a current plan instrument, including all plan amendments

d. Administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants

.72 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A107)

Auditor's Responsibilities for the Audit of the Financial Statements

.73 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.74 This section of the auditor's report should do the following: (Ref: par. .A108)

a. State that the objectives of the auditor are to

  i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (Ref: par. .A109)

  ii. issue an auditor's report that includes the auditor's opinion

b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A110)

c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control

d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[9](Ref: par. .A111)

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

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[9]Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*.

.75 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

a. Exercise professional judgment and maintain professional skepticism throughout the audit.

b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed.

   In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed."

d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time.

.76 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that the auditor identified during the audit.

ERISA-Required Supplemental Schedules

.77 As discussed in paragraph .127, when auditing ERISA plan financial statements, the auditor is required to report on whether the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, in accordance with section 725 and paragraphs .129–.130 of this section, as applicable.

Other Reporting Responsibilities

.78 If the auditor addresses other reporting responsibilities in the auditor's report on the ERISA plan financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory

Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A112–.A113)

.79 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements in paragraphs .61–.77 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A114)

Signature of the Auditor

.80 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A115–.A116)

Auditor's Address

.81 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A117–.A118)

Date of the Auditor's Report

.82 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 ERISA plan financial statements, including evidence of the following: (Ref: par. .A119)

a. All the statements and disclosures that the ERISA plan financial statements comprise have been prepared.

b. Management has asserted that it has taken responsibility for those ERISA plan financial statements. (Ref: par. .A120–.A121)

c. The procedures relating to the draft Form 5500 have been performed.

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards

.83 Paragraph .67 requires that the auditor's report state that the audit was conducted in accordance with GAAS and identify the United States of America as the country of origin of those standards. However, an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing [ISAs], or *Government Auditing Standards*). The auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS, unless the audit was conducted in accordance with both sets of standards in their entirety.

.84 When the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as its origin.

Comparative Financial Statements

.85 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the auditor's report should refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: par. .A122–.A124)

.86 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. (Ref: par. .A125–.A126)

Audit Procedures

.87 The auditor should perform the procedures required by paragraphs .88–.90 if comparative financial statements are presented for the prior periods.

.88 The auditor should determine whether the comparative financial statements have been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework.

.89 The auditor should evaluate the following:

a. Whether the comparative financial statements agree with the amounts and other disclosures presented in the prior period or, when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle

b. Whether the accounting policies reflected in the comparative financial statements are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed[10]

.90 If the auditor becomes aware of a possible material misstatement in the comparative financial statements while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period's financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the relevant requirements of section 560. If the prior period financial statements are restated, the auditor should determine that the comparative financial statements agree with the restated financial statements.

[10]See section 708, *Consistency of Financial Statements*.

.91 As required by section 580, the auditor should request written representations for all periods referred to in the auditor's opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements. (Ref: par. .A127)

.92 When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706:

a. The date of the auditor's previous report

b. The type of opinion previously expressed

c. The substantive reasons for the different opinion

d. That the auditor's opinion on the amended financial statements is different from the auditor's previous opinion (Ref: par. .A128)

Prior Period Financial Statements Audited by a Predecessor Auditor

.93 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued,[11]in addition to expressing an opinion on the current period's financial statements, the auditor should state the following in an other-matter paragraph:[12]

a. That the financial statements of the prior period were audited by a predecessor auditor

b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore

c. The nature of an emphasis-of-matter paragraph, other-matter paragraph, or a going concern section included in the predecessor auditor's report, if any

d. The date of that report

.94 If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor should follow the communication requirements in section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.[13] If the prior period financial statements are restated, and the predecessor auditor agrees to issue

[11]Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[12]See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

[13]Paragraphs .12–.13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

a new auditor's report on the restated financial statements of the prior period, the auditor should express an opinion only on the current period. (Ref: par. .A129)

Prior Period Financial Statements Not Audited

.95 When current period financial statements are audited and presented in comparative form with financial statements for the prior period for which a compilation or review was performed, and the report on the prior period is not reissued, the auditor should include an other-matter paragraph[14]in the current period auditor's report that includes the following with respect to the prior period: (Ref: par. .A130)

a. The service performed in the prior period

b. The date of the report on that service

c. A description of any material modifications noted in that report

d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A131)

e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A132)

.96 If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (Ref: par. .A133)

Information Presented in the Financial Statements

.97 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. (Ref: par. .A134–.A136)

Auditor's Report for an ERISA Section 103(a)(3)(C) Audit

.98 The auditor's report should be in writing. (Ref: par. .A86–.A87)

.99 The auditor should apply the provisions in paragraphs .83–.97, when applicable. (Ref: par. .A137)

Title

.100 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A88)

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[14]See footnote 12.

Addressee

.101 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A89–.A90)

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

.102 The first section of the auditor's report should include a description of the scope and nature of the ERISA Section 103(a)(3)(C) audit and should have the heading "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit."

.103 The "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section of the auditor's report should also do the following:

a. Identify the plan whose financial statements have been audited

b. State that the auditor performed an audit of the financial statements of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit) (Ref: par. .A138)

c. Identify the title of each statement that the financial statements comprise

d. Refer to the notes

e. Specify the dates of or periods covered by each financial statement that the financial statements comprise

f. State that management, having determined it is permissible in the circumstances, has elected to have the audit of the plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (Ref: par. .A139)

g. State that as permitted by ERISA Section 103(a)(3)(C), the audit need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution) (Ref: par. .A140)

h. State that management has obtained a certification [*or certifications*] from a qualified institution as of [*date or dates*], and for the [*period or year ended date*], stating that the certified investment information, as described in [*insert note reference*] to the financial statements is complete and accurate

Auditor's Opinion

.104 The auditor's report should include the "Opinion" section, directly following the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section, with the heading "Opinion."

.105 When the auditor has not identified any material misstatements of the financial statements and no scope limitations exist, the auditor's report should include a statement that, in the auditor's opinion, based on the audit and on the procedures performed as described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section

a. the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

b. the information in the accompanying financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C). (Ref: par. .A140)

.106 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A98)

Basis for Opinion

.107 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion" that does the following: (Ref: par. .A99)

a. States that the audit was conducted in accordance with generally accepted auditing standards (GAAS) and identifies the United States of America as the country of origin of those standards (Ref: par. .A100–.A101)

b. Refers to the section of the auditor's report that describes the auditor's responsibilities for GAAS

c. Includes a statement that the auditor is required to be independent of the plan and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A102–.A103)

d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the ERISA Section 103(a)(3)(C) audit opinion.

Going Concern

.108 When applicable, the auditor should report in accordance with section 570.

Key Audit Matters

.109 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A104)

Responsibilities of Management for the Financial Statements

.110 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.111 This section of the auditor's report should describe management's responsibility for the following:

a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for 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. (Ref: par. .A105–.A106)

b. The election of the ERISA Section 103(a)(3)(C) audit and that the election does not affect management's responsibility for the financial statements.

c. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework*, as applicable.]

d. Maintaining a current plan instrument, including all plan amendments

e. Administering the plan and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

.112 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A107)

Auditor's Responsibilities for the Audit of the Financial Statements

.113 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.114 This section of the auditor's report should do the following: (Ref: par. .A108)

a. State that except as described in the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section of the report, the objectives of the auditor are to

   i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and (Ref: par. .A109)

   ii. issue an auditor's report that includes the auditor's opinion.

b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A110)

c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.[15](Ref: par. .A111)

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.115 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

a. Exercise professional judgment and maintain professional skepticism throughout the audit

b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed.

   In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following "but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed."

d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

[15]See footnote 9.

e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time.

.116 The auditor's report should state that the audit did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of the applicable financial reporting framework.

.117 The auditor's report should state that, accordingly, the objective of the ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.118 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal-control-related matters that the auditor identified during the audit.

Modifications to the Opinion

.119 Section 705 addresses the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with this SAS, the auditor concludes that a modification to the auditor's opinion on the ERISA plan financial statements is necessary. In the case of an ERISA Section 103(a)(3)(C) audit, the auditor should apply the requirements in section 705, adapted as necessary in the circumstances of the engagement, including the following: (Ref: par. .A141–.A142)

a. When the auditor expresses a qualified opinion due to a material misstatement of the financial statements, the auditor should amend the "Opinion" section as required by paragraph .105, to state that, in the auditor's opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" section, based on the audit and on the procedures performed as described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section

    i. the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

    ii. the information in the accompanying financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C). (Ref: par. .A140)

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase *except for the possible effects of the matter(s)...* for the modified opinion.

b. When the auditor expresses an adverse opinion, the requirements in paragraph .105 do not apply, and the auditor should state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matters described in the "Basis for Adverse Opinion" section, the financial statements are not presented fairly in accordance with the applicable financial reporting framework.

c. When the auditor expresses a qualified or an adverse opinion, the auditor should amend the description in the "Basis for Opinion" section to state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified ERISA Section 103(a)(3)(C) audit opinion.

d. When the auditor disclaims an opinion, the auditor should amend the statement required by paragraph .103*b*, which indicates that the auditor performed an audit of the financial statements, to state that the auditor was engaged to perform an audit of the financial statements. The auditor should also amend the description of the auditor's responsibility for the audit of the financial statements and the description of the scope of the audit to state only the following: "Our responsibility is to conduct an audit of the plan's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the "Basis for Disclaimer of Opinion" section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements."

e. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the requirements in paragraph .105 do not apply, and the auditor should state in the "Disclaimer of Opinion" section that

    i. because of the significance of the matters described in the "Basis for Disclaimer of Opinion" section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and

    ii. accordingly, the auditor does not express an opinion on the financial statements.[16]

ERISA-Required Supplemental Schedules

.120 The auditor's report should include an other-matter paragraph with the heading "Other Matter — Supplemental Schedules Required by ERISA."

.121 The auditor should report on ERISA-required supplemental schedules in accordance with paragraph .132 of this section.

[16]Paragraph .20 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Other Reporting Responsibilities

.122 If the auditor addresses other reporting responsibilities in the auditor's report on the ERISA plan financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A143–.A144)

.123 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements in paragraphs .102–.121 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A145)

Signature of the Auditor

.124 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A115–.A116)

Auditor's Address

.125 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A117–.A118)

Date of the Auditor's Report

.126 The auditor's report should be dated no earlier than the date on which the auditor has obtained an appropriate certification and has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the ERISA plan financial statements, including evidence of the following: (Ref: par. .A119)

a. All the statements and disclosures that the ERISA plan financial statements comprise have been prepared.

b. Management has asserted that they have taken responsibility for those ERISA plan financial statements. (Ref: par. .A120–.A121)

c. The procedures relating to the draft Form 5500 have been performed.

Reporting on Supplemental Schedules

.127 As discussed in paragraph .04, ERISA requires that certain supplemental schedules accompany the ERISA plan financial statements (referred to as *ERISA-required supplemental schedules*), if applicable. In addition, ERISA plan financial statements may have accompanying supplementary information that is not required by ERISA. Except as discussed in paragraph .132, when auditing ERISA plan financial statements, the auditor should report on whether the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, in accordance with section 725 and paragraphs .129–.130 of this section. Section 725 addresses the performance requirements as well as the form and content of the report on supplementary information in relation to the financial statements as a whole. Section 725 requires the auditor to report on the supplementary information in either (*a*) a separate section in the auditor's report on the financial statements with the heading "Supplementary Information" or other appropriate heading or (*b*) in a separate report on the supplementary information. Paragraphs .22–.24 address additional considerations related to reporting on the ERISA-required supplemental schedules when prohibited transactions with a party in interest exist. (Ref: par. .A146–.A147) [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.128 When the auditor is also engaged to report on supplementary information accompanying the ERISA plan financial statements that is not required by ERISA, and that is not required by the applicable financial reporting framework, section 725 applies. (Ref: par. .A148)

ERISA-Required Supplemental Schedules

.129 *Reporting on ERISA-Required Supplemental Schedules When Performing an Audit of ERISA Plan Financial Statements Not Subject to ERISA Section 103(a)(3)(C).*[17] When reporting on the ERISA-required supplemental schedules in accordance with section 725, the reporting elements discussed in paragraph .09 of section 725 should be replaced with the following (see paragraph .132 when performing an ERISA Section 103(a)(3)(C) audit):

a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole

b. The title of the supplemental schedules and the periods covered

c. A statement that the supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA

d. A statement that such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements

e. A statement that the information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America

f. A statement that in forming the auditor's opinion on the supplemental schedules, the auditor evaluated whether the supplemental schedules, including their form

[17]For ERISA Section 103(a)(3)(C) audits, paragraphs .131–.132 apply instead of paragraphs .129–.130.

and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA

g. When the auditor's report on the audited ERISA plan financial statements contains an unmodified opinion and the auditor has concluded that the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. (Ref: par. .A149–.A152)

h. When the auditor's report on the audited ERISA plan financial statements contains a qualified opinion and the qualification has an effect on the ERISA-required supplemental schedules, a statement that, in the auditor's opinion, except for the effects or possible effects on the supplemental schedules of (refer to the paragraph in the auditor's report explaining the qualification), the information in the accompanying supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA

.130 When the auditor's report on the audited ERISA plan financial statements contains an adverse opinion or a disclaimer of opinion, the auditor is precluded from expressing an opinion on the ERISA-required supplemental schedules. When permitted by law or regulation, the auditor may withdraw from the engagement to report on the ERISA-required supplemental schedules. If the auditor does not withdraw, the reporting elements in paragraph .11 of section 725 should be replaced with the following:

a. If the auditor's report on the audited ERISA plan financial statements contains an adverse opinion, a statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole, or if the auditor's report contains a disclaimer of opinion, a statement that the auditor was engaged for the purpose of forming an opinion on the financial statements as a whole

b. A statement that the supplemental schedules are presented for the purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the DOL's Rules and Regulations for Reporting and Disclosure under ERISA.

c. A statement that because of the significance of the matter described in the auditor's report (refer to the "Basis for Adverse Opinion" or "Basis for Disclaimer of Opinion" sections, as applicable), it is inappropriate to, and the auditor does not, express an opinion on the supplemental schedules

.131 *Reporting on ERISA-Required Supplemental Schedules When Reporting Under an ERISA Section 103(a)(3)(C) Audit.* In addition to the procedures performed during the audit of the ERISA plan financial statements (including the procedures required by paragraph

.32), in order to report on the ERISA-required supplemental schedules when reporting under an ERISA Section 103(a)(3)(C) audit, the auditor should perform the following procedures using the same materiality level used in the audit of the financial statements:

a. Determine whether the form and content of the ERISA-required supplemental schedules, other than the information that agreed to or is derived from the certified investment information, is presented in conformity with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA

b. Compare and reconcile the information included in the ERISA-required supplemental schedules, other than that agreed to or derived from the certified investment information, to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves

c. Obtain written representations from management

   i. that it acknowledges its responsibility for the presentation of the ERISA-required supplemental schedules in accordance with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA and

   ii. that it believes the ERISA-required supplemental schedules, including their form and content, are presented in conformity with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA

.132 When management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor should include an other-matter paragraph in the ERISA Section 103(a)(3(C) audit report that contains the following elements:

a. The title of the supplemental schedules and the periods covered.

b. A statement that the supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

c. A statement that such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements.

d. A statement that the information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

e. A statement that, for information included in the supplemental schedules that agreed to or is derived from the certified investment information, the auditor compared such information to the related certified investment information.

f. A statement that, in forming the auditor's opinion on the supplemental schedules, the auditor evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

g. A statement whether, in the auditor's opinion

    i. the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

    ii. the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

h. If the auditor issues a qualified ERISA Section 103(a)(3)(C) opinion on the ERISA plan financial statements and the qualification has an effect on the ERISA-required supplemental schedules, a statement that, in the auditor's opinion, except for the effects of [*describe the matters by referring to the section in the auditor's report explaining the qualification*] on the supplemental schedules of [*identify the schedules*]

    i. the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

    ii. the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

    When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase *except for the possible effects of the matter(s)...* for the modified opinion.

i. If the auditor's report on the ERISA plan financial statements subject to ERISA Section 103(a)(3)(C) contains an adverse opinion or a disclaimer of opinion, the auditor is precluded from expressing an opinion on the supplemental schedules. When permitted by law or regulation, the auditor may withdraw from the engagement to report on the ERISA-required supplemental schedules. If the auditor does not withdraw, the auditor should do the following:

i. Include a statement that the supplemental schedules are presented for the purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA

ii. Include a statement that such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements

iii. Include a statement that because of the significance of the matter described in [*refer to the Basis for Adverse Opinion or Basis for Disclaimer of Opinion sections, as applicable*], it is inappropriate to and the auditor does not express an opinion on the supplemental schedules.

.133 *Errors, Omissions, or Inconsistencies in ERISA-Required Supplemental Schedules (Ref: par. .A149–.A152)*. When the auditor concludes, on the basis of the procedures performed, that the information in the ERISA-required supplemental schedules is materially inconsistent with the certified investment information, the auditor should discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedules are not revised, the auditor should modify the auditor's opinion regarding the ERISA-required supplemental schedules and describe the inconsistency in the auditor's report.

.134 When the auditor concludes, on the basis of the procedures performed, that the information in the ERISA-required supplemental schedules is materially misstated in relation to the financial statements, the auditor should discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedules are not revised, the auditor should modify the auditor's opinion regarding the ERISA-required supplemental schedules and describe the misstatement in the auditor's report. (Ref: par. .A149)

.135 If a material prohibited party-in-interest[18] transaction that is not disclosed in the ERISA-required supplemental schedule is also considered a related party transaction and if that transaction is not properly disclosed in the notes to the ERISA plan financial statements, the requirements in paragraph .24 apply.

[18]*Party in interest* is defined in Section 3(14) of ERISA.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.12)

.A1 The AICPA Audit and Accounting Guide *Employee Benefit Plans* provides interpretive guidance to apply this section, including example audit procedures for performing an audit of ERISA plan financial statements. Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to consider applicable interpretive publications in planning and performing the audit.[19]

.A2 ERISA provides for federal government oversight of management's operating and reporting practices for EBPs. In addition to establishing reporting requirements for covered plans, ERISA establishes minimum standards for participation, vesting, and funding for defined benefit and defined contribution plans sponsored by private entities. It also establishes standards of fiduciary conduct and imposes specific restrictions and responsibilities on fiduciaries.

.A3 The plan administrator is identified in the plan document as having responsibility for managing the day-to-day administration and decisions for the plan. This section uses the term management to include the plan administrator as described in the DOL's Rules and Regulations for Reporting and Disclosure under ERISA as well as other members of management.

.A4 Under ERISA, the DOL and IRS have the authority to issue regulations governing the administration of EBPs, including reporting and disclosure requirements to be included in an annual filing with the DOL. The DOL does not establish the financial reporting framework, for example, the DOL does not set generally accepted accounting principles for ERISA plan financial statements. The selection of an acceptable financial reporting framework is the responsibility of management. The PBGC guarantees participants in most private-sector defined benefit pension plans certain minimum pension benefits if the plan terminates without sufficient money to pay all benefits, and it administers terminated plans in certain circumstances. The IRS, DOL, and PBGC have consolidated their reporting and disclosure requirements into Form 5500 to minimize the filing burden for plan management.

.A5 ERISA contains a requirement for annual audits of EBP financial statements by an independent qualified public accountant. Generally, plans with 100 or more participants (as defined in the Form 5500 instructions) are subject to the audit requirement. ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in supplemental schedules. ERISA also contains a requirement for the auditor to report on whether certain supplemental schedules, as identified in ERISA Section 103, are presented fairly, in all material respects, in relation to the financial statements as a whole.

[19]Paragraph .27 of section 200.

.A6 A qualified institution is an organization as defined in accordance with 29 CFR 2520.103-5 and 29 CFR 2520.103-8 as a bank or similar institution that holds plan assets, or an insurance carrier which provides benefits under the plan or holds plan assets, that is regulated, supervised, and subject to periodic examination by a state or federal agency that prepares and certifies the investment information. The DOL's Rules and Regulations for Reporting and Disclosure under ERISA are outlined in 29 CFR 2520.103-1. Investment companies and broker-dealers are not considered qualified institutions as it relates to providing a certification.

.A7 An ERISA Section 103(a)(3)(C) audit may be elected by management only when a qualified institution certifies both the accuracy and completeness of the investment information submitted to the plan administrator. Certifications that address only accuracy or only completeness, but not both, do not comply with the DOL's regulation and, therefore, are not adequate to allow plan management to elect an ERISA Section 103(a)(3)(C) audit.

.A8 When performing an ERISA Section 103(a)(3)(C) audit, although the audit need not extend to investment information as discussed in paragraph .08, areas such as participant data; contributions; benefit payments; participant account balances, including related earnings and other allocations to such account balances; or other information would be subject to audit procedures, regardless of whether such information is included in the certified statement or information.

.A9 An ERISA Section 103(a)(3)(C) audit may relate to the audit of the plan's investment in an entity, as permitted by 29 CFR 2520.103-12 (a 103-12 investment entity), provided the 103-12 investment entity properly filed its report with the DOL. Accordingly, the guidance in this section is applicable whether an ERISA Section 103(a)(3)(C) audit is being performed pursuant to 29 CFR 2520.103-8 or 29 CFR 2520.103-12. However, the wording in the auditor's report may need to be revised to adapt to the circumstances of the engagement.

.A10 Sometimes, the plan's recordkeeper certifies the investment information on behalf of the plan's qualified institution as "agent for." In this situation, such certification generally would be acceptable when there is a contractual arrangement between a qualified institution and the recordkeeper such that the recordkeeper is able to provide the certification on the qualified institution's behalf.

.A11 ERISA requires certain comparative financial statements to be presented.

.A12 Paragraph .32 describes the auditor's responsibilities with respect to the disclosures in the financial statements covered by the certification.

.A13 As discussed in paragraph .A47, an ERISA Section 103(a)(3)(C) audit is unique to EBPs and is not considered a scope limitation as discussed in section 705. For an ERISA Section 103(a)(3)(C) audit, paragraph .119 requires the auditor to apply the requirements in section 705, adapted as necessary in the circumstances of the engagement, and provides further guidance on how section 705 should be adapted.

.A14 Section 800 also addresses the auditor's responsibilities when the auditor is reporting on financial statements prepared in accordance with a special purpose framework and is required by law or regulation to use a specific layout, form, or wording of the auditor's report. When reporting on financial statements prepared in accordance with a general purpose framework, and law or regulation requires a specific layout, form, or wording of the auditor's report, the auditor may adapt and apply the requirements in section 800.

.A15 Other AU-C sections that also contain reporting requirements include, but are not limited to, the following:

- Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Section 730, *Required Supplementary Information*

Engagement Acceptance (Ref: par. .15)

.A16 The concept of an independent audit requires that the auditor not assume management's responsibility for the preparation and fair presentation of the financial statements. When the auditor assists in drafting the financial statements, in whole or in part, based on information provided by management during the performance of the audit, such assistance is considered a nonattest service under the "Nonattest Services" interpretation (ET sec 1.295) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. Before performing nonattest services, the auditor is required to establish and document in writing the auditor's understanding with the client regarding the objectives of the engagement, services to be performed, client's acceptance of its responsibilities, auditor's responsibilities, and any limitations of the engagement.

.A17 A draft of Form 5500 that is substantially complete includes the forms and schedules that could have a material effect, involving both qualitative and quantitative considerations, on the information in the financial statements and ERISA-required supplemental schedules.

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements (Ref: par. .18–.20)

.A18 Section 300, *Planning an Audit*, requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and that guides the development of the audit plan.[20] The audit plan should include a description of the nature and extent of planned risk assessment procedures as determined under section 315A; the nature, timing, and extent of planned further audit procedures at the relevant assertion level as determined under section 330; and other planned audit procedures that are required to be carried out so that the engagement complies with GAAS.[21]

[20]Paragraph .07 of section 300, *Planning an Audit*.

.A19 Obtaining an understanding of the plan and its environment, the applicable financial reporting framework, and its internal control, is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The auditor's understanding of the plan establishes a frame of reference for planning the audit and exercising professional judgment throughout the audit when the auditor does the following:

- Assesses the risks of material misstatement of the financial statements, including the related disclosures
- Determines materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*
- Considers the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures
- Identifies areas for which special audit consideration may be necessary
- Develops expectations for use when performing analytical procedures
- Responds to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence
- Evaluates the sufficiency and appropriateness of audit evidence obtained[22]

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A20 SAS No. 145 requires the auditor to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.[23] The consideration of risks of material misstatement at the relevant assertion level for significant classes of transactions, account balances, and disclosures directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A21 Section 330 requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.[24]Further audit procedures consist of tests of the operating effectiveness of controls and substantive procedures. Additionally, section 330 requires the auditor to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework.[25]

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[21]Paragraph .09 of section 300.

[22]Paragraph .A1 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[23]Paragraph .05 of section 315.

[24]Paragraph .06 of section 330.

.A22 ERISA Section 402 requires that EBPs be established and maintained pursuant to a written plan instrument. The IRC requires that the provisions in the plan document satisfy the requirements of the IRC; therefore, the plan provisions are required to be followed. The plan instrument for defined benefit pension plans and defined contribution pension plans is generally referred to as a plan document. Multiple documents for such plans, as well as health and welfare plans, may comprise the plan instrument. Among other requirements, for a plan to be qualified, the plan instrument must be in writing and communicated to employees. The terms of the plan instrument generally deal with matters such as eligibility of participants, entitlement to benefits, funding, plan amendments, operation and administration of plan provisions, identification of the plan's fiduciary, allocation of responsibilities among those who serve in a capacity as a fiduciary, and delegation of fiduciary duties in connection with the administration of the plan.

.A23 Management is responsible for determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in accordance with the plan instrument. Although some of the provisions of the plan instrument may not relate directly to accounts that are presented as financial statement account balances, they could affect matters such as disclosures, the tax qualified status of the plan, or the benefits that will be paid to participants when they become eligible for a distribution. For example, participant account balances are an accumulation of transactions and represent the amount that the participant is entitled to receive as a benefit payment. Overstated or understated participant account balances may result in errors in allocations or benefits paid to participants.

.A24 Participant data plays an important role in determining many of the account balances in the financial statements. The types of participant data that are tested in an ERISA plan audit will vary from plan to plan, depending upon the bases on which contributions, participant elections, participant allocations, and benefits are determined. In general, the data tested may include demographic data, such as birth date, marital status, date of hire, date of termination, and other demographic data that determines eligibility and vesting; payroll data, such as hours worked, earnings, and contributions to the plan; benefit data for participants receiving benefits; and participant elections for salary deferral percentage and investment elections. The procedures for testing payroll and participant data may be coordinated with those for plan contributions.

.A25 Many of the financial statement amounts in ERISA plan financial statements are determined from provisions specified in the plan instrument. For example, conditions relating to participation and eligibility provisions need to be met for employees to participate in the plan and receive contributions. Participation and eligibility provisions may be tested as part of the auditor's testing of contributions and individual participant accounts.

.A26 Other typical plan provisions include types of contributions and distributions, timing of the contributions, contribution limitations, investment of contributions, forms of distributions, benefit commencement dates, vesting and forfeitures, service requirements and credits, participant loans, transfers, and administration of plan.

[25] Paragraph .26 of section 330.

.A27 Because of the nature of ERISA plan engagements, it would be rare for the auditor, based upon the assessed risks of material misstatement at the relevant assertion level, not to test any relevant plan provisions.

.A28 Appendix A to this section provides some examples of plan provisions often included in a plan instrument by audit area.

Plan Tax Status (Ref: par. .21)

.A29 When plans are granted special tax status for the contributions and earnings on plan investments to be exempt from taxation (tax-exempt status), such plans are required to be designed and operated in accordance with IRC requirements in order to maintain their tax-exempt status. Accordingly, the plan's tax status is fundamental to the plan.

.A30 To determine if a plan is operating within the specific guidelines established by the plan instrument in accordance with the IRC, management is responsible for conducting certain nondiscrimination and other compliance tests, which are required to be performed at least annually, unless otherwise provided by the IRC.

.A31 The auditor's consideration of whether the plan has performed and passed, corrected, or intends to correct failures of relevant IRC compliance tests may include inquiry and inspection.

.A32 The AICPA Audit and Accounting Guide *Employee Benefit Plans* discusses the tax status of EBPs, including nondiscrimination and other operating tests for plan qualification.

Prohibited Transactions (Ref: par. .22–.24)

.A33 A party in interest is defined in Section 3(14) of ERISA. The AICPA Audit and Accounting Guide *Employee Benefit Plans* contains common examples of parties that may be related parties, parties in interest, or both.

.A34 Certain plan transactions with parties in interest are prohibited under Sections 406 and 407 of ERISA (referred to as *prohibited transactions*) and are required, without regard to their materiality, to be disclosed to the DOL in the plan's Form 5500 if they occur.

.A35 Evaluating whether identified prohibited transactions have been appropriately reported in the ERISA-required supplemental schedule is often performed in conjunction with reading the draft Form 5500 and performing procedures on the ERISA-required supplemental schedule as discussed in paragraphs .127–.135.

.A36 ERISA requires that all transactions with parties in interest (excluding any transactions exempted from prohibited transaction rules) be disclosed in the ERISA-required supplemental schedule without regard to their materiality. For example, information on all delinquent participant contributions are required to be reported on Schedule H of Form 5500. Large plans with delinquent participant contributions are required to attach a Schedule of Delinquent Participant Contributions. All other prohibited transactions are reported on the Schedule of Nonexempt Transactions.

Evaluation and Documentation (Ref: par. .25)

.A37 Paragraph .27 of this section requires the auditor to communicate to those charged with governance the reportable findings from the audit procedures performed relating to the plan provisions. Section 230[26] requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements;

b. the results of the audit procedures performed and the audit evidence obtained; and

c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Communication With Management or Those Charged With Governance (Ref: par. .27–.28)

.A38 The requirements of section 250 are designed to assist the auditor in identifying material misstatement of the financial statements due to noncompliance with laws and regulations. Section 250 requires the auditor to communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential, unless all those charged with governance are involved in management of the entity and aware of matters involving identified or suspected noncompliance already communicated by the auditor.[27]

.A39 Section 260[28] requires the auditor to communicate with those charged with governance significant findings or issues from the audit. Such communication includes findings or issues 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. For an ERISA plan, this may include operational errors that have been identified by the auditor as part of the audit when testing the plan provisions of the plan instrument.

.A40 It is important for the plan administrator, as part of his or her fiduciary responsibilities, to be informed about reportable findings identified during the audit so that the plan administrator can decide whether to participate in the IRS or DOL correction programs, if applicable. The auditor may want to discuss his or her reportable findings with the plan administrator prior to the written communication so that the plan administrator can take corrective action in a timely manner.

.A41 For the purposes of communications with those charged with governance, section 260 requires the auditor to determine the appropriate person or persons within the entity's

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[26]Paragraph .08 of section 230, *Audit Documentation*.

[27]Paragraph .21 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

[28]Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

governance structure with whom to communicate. When the appropriate person or persons with whom to communicate is not clearly identifiable, the auditor and the engaging party may need to discuss and agree on the relevant persons within the entity's governance structure with whom the auditor will communicate.

.A42 For an ERISA plan, the appropriate person or persons with whom to communicate may not be clearly identifiable from the engagement circumstances. Some plans have a formal board of trustees (or other formal governing body), and others do not. For a single-employer employee benefit plan, the individual charged with governance may include the individual with the level of authority and responsibility equivalent to an audit committee, such as the named fiduciary, which is often the plan sponsor or an officer thereof; the sponsor's board of directors or audit committee; or a committee overseeing the activities of the employee benefit plan, such as the employee benefit committee, employee benefit administrative committee, employee benefit investment committee, plan administrator, or other responsible party.

.A43 Section 265 requires the auditor to 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.[29] The auditor is required to 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.[30]

.A44 For an ERISA plan, instances identified by the auditor in which the plan is not operating in accordance with the plan's provisions may be indicative of a deficiency in internal control at the plan. If this is the case, the auditor is required to communicate such deficiency in accordance with section 265 when, in the auditor's professional judgment, the deficiency is of such importance to merit management's attention.

.A45 The communication of reportable findings relating to audit work performed that involved the testing of plan provisions may describe the plan provision relating to the reportable finding and may provide more details, or an explanation, about the reportable finding and its effect on the financial statements, if any. When explaining the potential effect of the reportable finding, the auditor need not quantify those effects.

.A46 Written communication indicating that no reportable findings were identified during the audit is precluded by paragraph .28 because such a communication has the potential to be misunderstood or misused.

Procedures for an ERISA Section 103(a)(3)(C) Audit (Ref: par. .29–.35)

.A47 The ERISA Section 103(a)(3)(C) audit is unique to EBPs and, as set forth in this standard, is not considered a scope limitation under section 705. The ability of management

[29]Paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

[30]Paragraph .12 of section 265.

to make this election is dependent on the qualifications of the institution preparing and certifying the investment information. However, if the institution is not qualified, the auditor is precluded from performing the ERISA Section 103(a)(3)(C) audit.

.A48 The nature of procedures necessary to evaluate management's assessment may vary depending upon the auditor's knowledge of the plan and types of investments held. In some instances, inquiry of management may be sufficient.

.A49 Implications for the audit, as discussed in paragraph .30, may include withdrawing from the audit when withdrawal is possible under applicable law or regulation or considering a change in the terms of the audit engagement in accordance with section 210A because the auditor is precluded from performing an ERISA Section 103(a)(3)(C) audit.

.A50 When planning and performing the audit procedures for an ERISA Section 103(a)(3)(C) audit, the materiality considerations apply to the financial statements as a whole.

.A51 A qualified institution may certify all plan activity. However, as discussed in paragraph .A8, the ERISA Section 103(a)(3)(C) audit and corresponding required procedures in paragraph .32 extend only to investment information certified by a qualified institution.

.A52 The certification and results of the procedures performed by the auditor in paragraphs .32–.33 are considered part of audit evidence relating to the certified investment information when determining whether the form of opinion required by paragraphs .98–.126 is appropriate.

.A53 Comparing involves agreeing or reviewing reconciliations of the certified investment information with the amounts included in the ERISA plan financial statements and related investment disclosures as well as the investment information included in the ERISA-required supplemental schedules. To the extent that the investment information in the ERISA plan financial statements and related disclosures and ERISA-required supplemental schedules cannot be agreed to or derived from the certified information, appropriate audit procedures would need to be performed on such information.

.A54 Additional procedures typically include further inquiry, which might result in additional testing. The auditor may want to consider the implications such additional procedures may have on the nature, timing, and extent of other audit procedures, including consideration for revisions to the engagement letter and risk assessment. Depending upon how the matter is resolved, the additional procedures may result in a modification to the auditor's opinion in accordance with section 705.

.A55 If the auditor becomes aware that the certified investment information has not been appropriately measured, presented, or disclosed and, therefore, the financial statements may not be prepared in accordance with the applicable financial reporting framework, it is important for the auditor to communicate the matter to management. It is management's responsibility to prepare the financial statements and disclosures in conformity with the applicable financial reporting framework and with the DOL Rules and Regulations for Reporting and Disclosure under ERISA. Management may request that the trustee or custodian recertify or amend the certification to exclude investments that are not appropriately measured or to reflect the appropriate investment valuation.

.A56 If the trustee or custodian amends the certification to exclude such investments from the certification, management is responsible for valuing such investments as of the plan year-end, and the auditor would need to perform audit procedures on the investments excluded from the certification.

.A57 If the certified information is inaccurate, incomplete, or otherwise unsatisfactory and the certification is not amended, management is still responsible for determining whether the financial statements and disclosures related to such investment information are prepared in accordance with the applicable financial reporting framework and in conformity with the DOL Rules and Regulations for Reporting and Disclosure under ERISA and may need to engage the auditor to perform audit procedures on such information.

.A58 Performing an ERISA Section 103(a)(3)(C) audit of ERISA plan financial statements does not eliminate the requirement for the auditor to plan and perform the audit in accordance with GAAS.

Written Representations (Ref: par. .36)

.A59 The AICPA Audit and Accounting Guide *Employee Benefit Plans* provides interpretative guidance on representations that may be appropriate when auditing ERISA plan financial statements. Section 725 requires specific written representations from management.[31]

.A60 Administering the plan is covered by ERISA Sections 401–404, which establish responsibilities and imposes restrictions on plan fiduciaries. ERISA Section 209 (29 USC 1027 *Retention of Records*) requires the maintenance of records by employers relating to individual benefit reporting. ERISA Section 107 (29 USC 1059 *Recordkeeping and Reporting Requirements*) provides general record retention requirements for EBPs. ERISA requires that records be maintained in sufficient detail to permit the benefits to be properly calculated and paid when due.

Forming an Opinion on the ERISA Plan Financial Statements (Ref: par. .37)

.A61 As described in section 200, a financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

Qualitative Aspects of the Entity's Accounting Practices (Ref: par. .39)

.A62 Management makes a number of judgments about the amounts and disclosures in the ERISA plan financial statements.

.A63 Section 260 contains a discussion of the qualitative aspects of accounting practices.[32] In considering the qualitative aspects of the plan's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude

[31]Paragraph .07 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.

[32]See the appendix, "Qualitative Aspects of Accounting Practices," in section 260.

that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

a. The selective correction of misstatements brought to management's attention during the audit

b. Possible management bias in the making of accounting estimates

.A64 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses possible management bias in making accounting estimates. Indicators of possible management bias themselves do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

.A65 *Accounting Policies Appropriately Disclosed in the ERISA Plan Financial Statements (Ref: par. 40*a). In evaluating whether the ERISA plan financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include matters such as the following:

- Whether the financial statements include all disclosures related to the significant accounting policies that are required by the applicable financial reporting framework
- Whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement, and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances, and disclosures in the financial statements in the particular circumstances of the plan's operations and its environment
- The clarity with which the significant accounting policies have been presented

.A66 *Information Presented in the Financial Statements Is Relevant, Reliable, Comparable, and Understandable (Ref: par. .40*d). Evaluating the understandability of the ERISA plan financial statements may include consideration of whether the information in the ERISA plan financial statements is presented in a manner that facilitates users' ability to identify necessary information. This may include whether the disclosures are appropriately labeled and cross-referenced.

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the ERISA Plan Financial Statements (Ref: par. .40)

.A67 It is common for ERISA plan financial statements prepared in accordance with a general purpose framework to present a plan's net assets available for benefits and changes in net assets available for benefits. For defined benefit pension plans, the financial statements may also present accumulated plan benefits and changes in accumulated plan benefits. For defined benefit health and welfare plans, the financial statements may also present plan benefit obligations and changes in plan benefit obligations. Evaluating whether, in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on (*a*) the plan's net assets available for benefits, (*b*) changes in net assets available for benefits, (*c*) accumulated plan benefits and changes in accumulated plan benefits (for defined benefit pension plans), and (*d*) plan benefit obligations and changes in plan benefit obligations (for defined benefit health and welfare plans) may include consideration of such matters as the following:

- The extent to which the information in the ERISA plan financial statements is relevant and specific to the circumstances of the plan
- Whether the disclosures are adequate to assist the intended users in understanding the following:
  - — The nature and extent of the plan's assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework
  - — The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses

Evaluating Whether the ERISA Plan Financial Statements Achieve Fair Presentation (Ref: par. .41)

.A68 Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. As noted in section 200, a *fair presentation financial reporting framework*[33] not only requires compliance with the requirements of the framework but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.

.A69 The auditor's evaluation about whether the ERISA plan financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the plan, including changes thereto, based on the auditor's understanding of the plan and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements as a whole.[34] [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

[33]Paragraph .14 of section 200.

[34]See section 320.

.A70 Evaluating whether the ERISA plan financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example, the following:

- The degree to which the amounts in the ERISA plan financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information, or results in misleading information
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted

.A71 The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of the following in the financial statements:

- Net assets available for benefits
- Accumulated plan benefits (for defined benefit pension plans)
- Plan benefit obligations (for defined benefit health and welfare plans)
- Changes in net assets available for benefits
- Changes in accumulated plan benefits (for defined benefit pension plans)
- Changes in plan benefit obligations (for defined benefit health and welfare plans)

Description of the Applicable Financial Reporting Framework (Ref: par. .42)

.A72 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.[35] That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

.A73 The description may indicate that the financial statements have been prepared in accordance with that framework. Such a statement is appropriate only when the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

.A74 Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

[35] Paragraphs .A2–.A3 of section 200.

.A75 The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework. Such information may not be required by the applicable financial reporting framework but may be presented as part of the basic financial statements. As discussed in paragraph .97, such information is considered an integral part of the financial statements if it cannot be clearly differentiated and, accordingly, is covered by the auditor's opinion.

Form of Opinion

Fair Presentation (Ref: par. .46)

.A76 In some instances, the ERISA plan financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. When this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in unusual circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements, which would be extremely rare.

.A77 The "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct states the following:

> A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Considerations Relating to Form 5500 Filing

Reading the Draft Form 5500 (Ref: par. .47–.49)

.A78 Paragraph .47 requires the auditor to obtain and read the draft Form 5500 prior to dating the auditor's report. Obtaining a draft Form 5500 prior to dating the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of facts with management on a timely basis. An agreement with management regarding when the Form 5500 will be filed may be helpful. A *misstatement of fact* is information contained in the Form 5500 unrelated to matters appearing in the audited ERISA plan financial statements that is incorrectly stated or presented.

Misstatements of fact may be identified by the auditor upon reading the draft Form 5500 for the purpose of identifying material inconsistencies, as discussed in paragraph .57.

.A79 Information in the draft Form 5500 may be relevant to an independent audit or the continuing propriety of the auditor's report. Information contained in the Form 5500 that conflicts with information contained in the audited ERISA plan financial statements is considered an inconsistency. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the ERISA plan financial statements.

.A80 Certain differences may exist between the Form 5500 Schedule H, *Financial Information*, and the ERISA plan financial statements. DOL rules and regulations require the notes to the ERISA plan financial statements to include an explanation of differences, if any, between the information contained in the separate ERISA plan financial statements and the net assets, liabilities, income, expense, and changes in net assets as required to be reported on the Form 5500 Schedule H. There are some differences that are not considered inconsistencies with Form 5500, for example, differences resulting from accruals recorded in the ERISA plan financial statements that are not reported in Form 5500 when Form 5500 is on a cash basis or benefits payable required to be reported on Form 5500 but not recorded in the ERISA plan financial statements. In contrast, a difference in investment categories may be due to a misclassification that may require correction in either the ERISA plan financial statements or Form 5500.

.A81 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Report Release Date That Require Revision of the Draft Form 5500 (Ref: par. .53)*. When management refuses to revise the information in the draft Form 5500, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.

.A82 *Material Inconsistencies Identified Subsequent to the Report Release Date (Ref: par. .54–.56)*. When revision of the information in Form 5500 is necessary after the report release date and management agrees to make the revision, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued ERISA plan financial statements, the auditor's report thereon, and Form 5500 are informed of the need for revision.

.A83 When revision of information in the Form 5500 is necessary after the report release date but management refuses to make the revision, appropriate further actions by the auditor may include obtaining legal advice.

Material Misstatement of Fact (Ref: par. .57–.59)

.A84 When discussing an apparent material misstatement of fact in the draft Form 5500 with management, the auditor may not be able to evaluate the validity of some disclosures included within the draft Form 5500 and management's responses to the auditor's inquiries and may conclude that valid differences of judgment or opinion exist.

.A85 When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate further actions by the auditor may include obtaining legal advice from the auditor's legal counsel, withholding the auditor's report if such report has not been released, or withdrawing from the engagement when withdrawal is possible under applicable law or regulation.

Auditor's Report on ERISA Plan Financial Statements (Other Than for an ERISA Section 103(a)(3)(C) Audit) (Ref: par. .60–.82)

.A86 A written report encompasses reports issued in hard copy format and those using an electronic medium.

.A87 Exhibit A, "Illustrations of Auditor's Reports on Financial Statements of Employee Benefit Plans Subject to ERISA," contains illustrations of auditor's reports on financial statements for ERISA plans. With the exception of the "Opinion"[36] and "Basis for Opinion" sections, this section does not establish requirements for ordering the elements of the auditor's report. However, this section requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with GAAS more recognizable, particularly in situations in which the elements of the auditor's report are presented in an order that differs from the illustrative auditor's reports in the exhibit to this section.

Title (Ref: par. .61 and .100)

.A88 Section 200 provides guidance on reporting when the auditor is not independent.[37]

Addressee (Ref: par. .62 and .101)

.A89 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not to those charged with governance of the entity whose financial statements are being audited.

.A90 For ERISA plans, the report may be addressed to the plan or trust whose ERISA plan financial statements are being audited, the plan administrator or board of trustees, or participants and beneficiaries.

Auditor's Opinion (Ref: par. .64)

.A91 The auditor's report states, for example, that the auditor has "audited the financial statements of ABC Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits as of December 31, 20X1 and 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements."

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[36]For an ERISA Section 103(a)(3)(C) audit this relates to the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section, the "Opinion" section, and the "Basis for Opinion" section of the report.

[37]Paragraph .A18 of section 200.

.A92 The identification of the title and the dates of, or periods covered by, each statement that the financial statements comprise may also be achieved by referencing the table of contents in a document bound with or accompanying the financial statements and auditor's report thereon.

.A93 When the auditor is aware that the audited financial statements will be included in a document that contains information in addition to the financial statements and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users identify the financial statements to which the auditor's report relates.

.A94 When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion because these suggest a conditional opinion or a weakening or modification of the opinion.

.A95 The auditor's opinion covers the complete set of ERISA plan financial statements, as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the ERISA plan financial statements include statements of net assets available for benefits and a statement of changes in net assets available for benefits; for defined benefit pension plans, a statement of accumulated plan benefits and a statement of changes in accumulated plan benefits; and for a defined benefit health and welfare plan, a statement of benefit obligations and statement of changes in benefit obligations, including related notes. In some circumstances, additional or different statements, schedules, or information also might be considered to be an integral part of the ERISA plan financial statements.

.A96 The reports in exhibit A include example wording that may be used to replace the [...] based on the applicable financial reporting framework.

.A97 The title of the financial statements identified in the "Opinion" section (see paragraph .64*c*) describes the information that is the subject of the auditor's opinion. For example, in the case of ERISA plan financial statements prepared in accordance with U.S. GAAP, these may include statements of net assets available for benefits (and of accumulated plan benefits) as of the end of the period and the statement of changes in net assets available for benefits (and of changes in accumulated plan benefits) for the period then ended. For defined benefit pension plans, the accumulated plan benefits and changes in accumulated plan benefits may be presented in the notes to the financial statements. The notes to the financial statements are an integral part of the financial statements, so the auditor's opinion covers these amounts regardless of whether they are presented in separate statements or in the notes to the financial statements. Therefore, the auditor is not required to make specific reference to the benefit information in the opinion paragraph of the auditor's report when the benefit information is presented in the notes to the financial statements.

.A98 *Description of the applicable financial reporting framework and how it may affect the auditor's opinion (Ref: par. .66).* The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph .41. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles.

Basis for Opinion (Ref: par. .67 and .107)

.A99 The "Basis for Opinion" section provides important context about the auditor's opinion. Accordingly, this section requires the "Basis for Opinion" section to directly follow the "Opinion" section in the auditor's report.

.A100 The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards. For example, the auditor's report may refer to auditing standards generally accepted in the United States of America or U.S. GAAS.

.A101 In accordance with section 200, the auditor does not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of section 200 and all other AU-C sections relevant to the audit.[38]

Relevant Ethical Requirements (Ref: par. .67c and .107c)

.A102 Section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.[39] When the AICPA Code of Professional Conduct applies, the auditor's other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, *Principles of Professional Conduct*). ERISA Section 103(a)(3)(A) requires that the accountant retained by an employee benefit plan be "independent" for purposes of examining plan financial information and rendering an opinion on the financial statements schedules required to be contained in the annual report. The DOL has issued guidelines (29 CFR 2509.75-9) for determining when an auditor is independent for purposes of auditing and rendering an opinion on the annual report.

.A103 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable, the rule or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources.

Key Audit Matters (Ref: par. .69 and .109)

.A104 Section 210A requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.[40]

[38] Paragraph .22 of section 200.

[39] Paragraph .A15 of section 200.

Responsibilities of Management for the Financial Statements (Ref: par. .70–.72 and .110–.112)

.A105 Section 200 explains the premise relating to the responsibilities of management and, when appropriate, those charged with governance on which an audit in accordance with GAAS is conducted.[41] Management and, when appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for 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. The description of management's responsibilities in the auditor's report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. Section 260 uses the term *those charged with governance* to describe the persons or organizations with responsibility for overseeing the plan, and provides a discussion about the diversity of governance structures among entities.

.A106 Management has additional responsibilities when arranging for an audit of ERISA plan financial statements due to the regulatory nature of such plans.

.A107 In some instances, a document containing the auditor's report may include a separate statement by management or those charged with governance regarding their responsibility for the preparation of the financial statements. Any elaboration in the auditor's report about the responsibilities of management or those charged with governance regarding the preparation of the financial statements, or reference to a separate statement by management or those charged with governance about such responsibilities if one is included in a document containing the auditor's report, may lead users to erroneously believe that the auditor is providing assurances about representations made by management or those charged with governance about their responsibility for financial reporting, internal control, and other matters that might be discussed in the management report.

Auditor's Responsibilities for the Audit of the Financial Statements (Ref: par. .73–.76 and .113–.118)

.A108 The description of the auditor's responsibilities as required by paragraphs .73–.76 or .113–.118 of this section may be tailored to reflect the specific nature of the plan.

.A109 *Objectives of the Auditor (Ref. par. .74 and .114).* The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion.[42] These objectives are

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[40]Paragraph .10 of section 210A, *Terms of Engagement*.

[41]Paragraphs .05 and .A2 of section 200.

[42]For an ERISA Section 103(a)(3)(C) audit, the auditor's report explains that, except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of the auditor's report, the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion.

in contrast to management's responsibilities for the preparation and fair presentation of the financial statements.

.A110 Because the auditor's opinion is based on obtaining reasonable assurance, the auditor's report does not constitute a guarantee. Because of the inherent limitation of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS.[43]

.A111 When the applicable financial reporting framework defines materiality differently from the definition in section 320, the auditor's report may need to reflect the definition or description of materiality from the applicable financial reporting framework.

Other Reporting Responsibilities (Ref: par. .78–.79)

.A112 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .78 will vary depending on the nature of the auditor's other reporting responsibilities.

.A113 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A114 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Signature of the Auditor (Ref: par. .80 and .124)

.A115 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm.

.A116 The DOL's Rules and Regulations for Reporting and Disclosure under ERISA contain requirements for how the accountant's report is to be signed for filing with the DOL.

Auditor's Address (Ref: par. .81 and .125)

.A117 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

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[43]Paragraph .A56 of section 200 and paragraph .10*d* of section 210A.

.A118 In accordance with 29 CFR 2520.103-1(b)(5)(i)(C) of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA, the auditor's report is required to indicate the city and state where it is issued.

Date of the Auditor's Report (Ref: par. .82 and .126)

.A119 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[44] When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.[45]

.A120 The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in section 560.

.A121 Because the auditor's opinion is provided on the ERISA plan financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that the financial statements comprise have been prepared, and management has accepted responsibility for them.

Comparative Financial Statements (Ref: par. .85)

.A122 The level of information included for the prior periods in comparative financial statements is comparable with that of the financial statements of the current period.

.A123 Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, use the ERISA Section 103(a)(3)(C) audit report, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented.

.A124 ERISA requires a statement of assets and liabilities of the plan to be displayed in comparative form. This may be achieved by presenting the statement of net assets available for benefits in comparative form.

Updating the Report (Ref: par. .86)

.A125 An updated report on prior period financial statements is distinguished from a reissuance of a previous report.[46] When issuing an updated report, the information

[44]See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

[45]Paragraph .21 of section 220A.

considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

Other Considerations Relating to Comparative Financial Statements (Ref: par. .86)

.A126 If one firm of independent auditors merges with another firm, and the new firm becomes the auditor of a former client of one of the two former firms, the new firm may accept responsibility and express an opinion on the financial statements for the prior periods, as well as on those for the current period. In such circumstances, paragraphs .85–.96 of this section apply. The new firm may indicate in the auditor's report or as part of the signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior period financial statements, the guidance for the reissuance of reports in section 560 would apply.

Written Representations (Ref: par. .91)

.A127 In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate.

Opinion on Prior Period Financial Statements Different From Previous Opinion (Ref: par. .92)

.A128 When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if, during the course of the audit of the current period, the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.[47]

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: par. .94)

.A129 The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements that have been restated. In this situation, provided that the auditor has audited the adjustments to the prior period financial statements, the auditor may include an other-matter paragraph[48] in the auditor's report indicating that the predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the auditor is engaged to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of the restatement, the auditor's report may also include the following paragraph within the other-matter paragraph:

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[46] See section 560.

[47] See footnote 46.

[48] See section 706.

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the Plan other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements as a whole.

Prior Period Financial Statements Not Audited (Ref: par. .95–.96)

.A130 When the auditor is auditing a plan that previously was not subject to audit, section 510 applies.

.A131 The following is an example of an other-matter paragraph when a review was performed on the prior period financial statements:

Other Matter

The 20X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 20X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in accordance with accounting principles generally accepted in the United States of America. A review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements as a whole.

.A132 The following is an example of an other-matter paragraph when a compilation was performed on the prior period financial statements:

Other Matter

We (other accountants) performed a compilation engagement with respect to the 20X1 financial statements and our (their) report thereon, dated March 1, 20X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

.A133 If the prior period financial statements were not audited, reviewed, or compiled, the following is an example of an other-matter paragraph:

Other Matter

The accompanying statement of net assets available for benefits of XYZ Plan as of December 31, 20X1, and the related statement of changes in net assets available for benefits for the year then ended were not audited, reviewed, or compiled by us and, accordingly, we do not express an opinion or any other form of assurance on them.

Information Presented in the Financial Statements (Ref: par. .97)

.A134 In some circumstances, the plan may be required by law, regulation, or standards, or may voluntarily choose, to include in the basic financial statements information that is not required by the applicable financial reporting framework. The auditor's opinion covers information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented.

.A135 ERISA requires certain items to be disclosed in the notes to the financial statements that may not also be required to be disclosed by the applicable financial reporting framework. Appendix A of the AICPA Audit and Accounting Guide *Employee Benefit Plans* contains a list of the disclosure items required by ERISA.

.A136 If the information included in the basic financial statements is not required by the applicable financial reporting framework and is not necessary for fair presentation but is clearly differentiated, then such information may be identified as *unaudited* or as *not covered by the auditor's report*.

Auditor's Report for an ERISA Section 103(a)(3)(C) Audit (Ref: par. .98–.126)

.A137 ERISA requires certain comparative financial statements to be presented; therefore, paragraphs .85–.96 apply even when performing an ERISA Section 103(a)(3)(C) audit.

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit (Ref: par. .103)

.A138 The auditor's report states, for example, that the auditor has "performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X1 and 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements."

.A139 Management may also elect to have an ERISA Section 103(a)(3)(C) audit when management has elected to file its audited financial statements in accordance with 29 CFR 2520.103-12 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA. In such circumstances, the report wording may need to be changed to reflect the circumstances of the engagement.

.A140 In accordance with ERISA, insurance entities may provide benefits under the plan or hold plan assets. Accordingly, the wording in the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section in paragraph .103*g* and the opinion in paragraph .104*b* may need to be revised.

Modifications to the Opinion (Ref: par. .119)

.A141 As discussed in paragraphs .A13 and .A47, an ERISA Section 103(a)(3)(C) audit is unique to EBPs and is not considered a scope limitation as discussed in section 705.

.A142 When performing an ERISA Section 103(a)(3)(C) audit, the auditor may encounter situations in which the financial statements are materially misstated or a limitation on the scope of the audit exists. For example, if the plan has not maintained sufficient accounting records and supporting documents and the auditor is unable to apply certain auditing procedures, the auditor may need to disclaim an opinion on the ERISA plan financial statements and ERISA-required supplemental schedules.

Other Reporting Responsibilities (Ref: par. .122–.123)

.A143 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .123 will vary depending on the nature of the auditor's other reporting responsibilities.

.A144 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A145 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Reporting on Supplemental Schedules (Ref: par. .127–.135)

.A146 According to 29 CFR 2520.103-10, the administrator of a plan filing an annual report pursuant to ERISA Section 2520.103-1(a)(2) should, as provided in the instructions to Form 5500, include as part of the annual report certain separate financial schedules.

.A147 Such schedules are required to be attached to the Form 5500 filing.[49]These schedules are covered by the auditor's report on whether such ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, in accordance with section 725. Form 5500 is updated annually and, therefore, Form 5500 contains the most current information about the required schedules.

.A148 The requirements in paragraphs .129–.135 apply only to the ERISA-required supplemental schedules, as applicable. When supplementary information that is not required by ERISA accompanies the financial statements, the auditor may also be engaged to report on whether the supplementary information not required by ERISA is fairly stated, in all material respects, in relation to the financial statements as a whole. In such circumstances, the auditor is required to follow the requirements in section 725 in its entirety, and the requirements in paragraphs .129–.135 of this section do not apply.

[49]Appendix A of the AICPA Audit and Accounting Guide *Employee Benefit Plans* provides a listing of the required ERISA schedules.

This may result in the inclusion of a separate section (as required by paragraph .129) or an other-matter paragraph (as required by paragraph .132) in the auditor's report, as applicable, relating to the ERISA-required supplemental schedules and a separate section relating to the other supplementary information accompanying the ERISA plan financial statements presented in accordance with section 725. [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Errors, Omissions, or Inconsistencies in ERISA-Required Supplemental Schedules

.A149 When the auditor concludes, on the basis of the procedures performed, that the ERISA-required supplemental schedules are materially misstated in relation to the financial statements as a whole, section 725 requires the auditor to discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules, the auditor is required to modify the auditor's opinion on the ERISA-required supplemental schedules and describe the misstatement in the auditor's report. If a separate report is being issued on the ERISA-required supplemental schedules, the auditor is required to withhold the auditor's report on the supplemental schedules.[50]

.A150 During the audit, the auditor may become aware of a departure from DOL requirements relating to the ERISA-required supplemental schedules that is not also a departure from the applicable financial reporting framework. In such circumstances, the auditor may consider including an additional discussion in the ERISA-required supplemental schedules section of the auditor's report (or for an ERISA Section 103(a)(3)(C) audit, the other-matter paragraph relating to the ERISA-required supplemental schedules) that describes the error, omission, or inconsistency. When the departure relates to a prohibited transaction with a party in interest, see paragraphs .22–.24.

.A151 When the auditor concludes that the supplemental schedules do not contain all required information or contain information that is inaccurate or inconsistent with the ERISA plan financial statements and the omission or inconsistency is not considered a material misstatement, the auditor may decide to include a discussion in the ERISA-required supplemental schedules section of the auditor's report (or for an ERISA Section 103(a)(3)(C) audit, the other-matter paragraph relating to the ERISA-required supplemental schedules) that describes the omission or inconsistency of the information.

.A152 Departures from the DOL requirements relating to the ERISA-required supplemental schedules includes omitted required information, information that is inaccurate or inconsistent with the ERISA plan financial statements, or an omitted ERISA-required supplemental schedule.

[50]Paragraph .13 of section 725.

Appendix A — Examples of Plan Provisions by Audit Area (Not All-Inclusive)

.A153

Paragraph .20 of this section requires the auditor to consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for significant classes of transactions, account balances, and disclosures when designing and performing audit procedures. The relevant plan provisions will vary for each type of plan and the circumstances of each engagement. When designing audit procedures, the testing of relevant plan provisions may be coordinated among the various audit areas to which they relate.

The following are some examples of plan provisions often included in a plan instrument by audit area (this list is not all-inclusive).

- *Individual Participant Accounts*
  - — Participation and eligibility requirements
  - — Types of contributions and distributions
  - — Timing of contributions
  - — Contribution limitations
  - — Investment of contributions
  - — Allocations to participant accounts
  - — Forms of distributions
  - — Benefit commencement dates
  - — Vesting and forfeitures
  - — Service requirements and credits
  - — Participant loans
  - — Transfers
  - — Administration of the plan
- *Contributions and Contributions Receivable*
  - — Participation and eligibility requirements
  - — Types of contributions
  - — Timing of contributions
  - — Contribution limitations

  - Investment of contributions
  - Use of forfeitures
  - Service requirements and credits
  - Allocations to participant accounts
- *Distributions and Related Obligations*
  - Eligibility requirements (distributable events)
  - Types of distributions
  - Forms of distribution
  - Benefit commencement dates
  - Determination of benefits
  - Vesting
  - Service requirements and credits
  - Allocations to participant accounts
- *Claims* (in a health and welfare plan)
  - Eligibility requirements
  - Types of claims
  - Claims coverage
  - Determination of claims
- *Loans to Participants*
  - Eligibility requirements
  - Loan terms
  - Allocations to participant accounts
- *Investments and Investment Income*
  - Investment of contributions
  - Administrative provisions
  - Direction of investments
  - Allocations to participant accounts
- *Expenses*
  - Administrative provisions

— Allocations to participant accounts

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Exhibit A — Illustrations of Auditor's Reports on Financial Statements of Employee Benefit Plans Subject to ERISA

.A154

Illustration 1 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA

Illustration 2 — An Auditor's Report on Financial Statements for a Defined Benefit Pension Plan Subject to ERISA

Illustration 3 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects the ERISA Section 103(a)(3)(C) Audit

Illustration 4 — An Auditor's Report Containing a Qualified Opinion on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 5 — An Auditor's Report Containing an Adverse Opinion on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion, Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence Because the Plan Has Not Maintained Sufficient Accounting Records, on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 1 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA

Circumstances include the following:

- Audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion on the ERISA plan financial statements is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as a separate section in accordance with paragraphs .129–.130. The auditor has concluded that the information in the ERISA-required supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Independent Auditor's Report

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets available for benefits of ABC 401(k) Plan as of December 31, 20X2 and 20X1, and the changes in its net assets available for benefits for the year ended

December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

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

Supplemental Schedules Required by ERISA

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — An Auditor's Report on Financial Statements for a Defined Benefit Pension Plan Subject to ERISA

Circumstances include the following:

- Audit of a complete set of general purpose financial statements for a defined benefit pension plan subject to ERISA (comparative statements of net assets available for benefits and accumulated plan benefits [end-of-year benefit information date] and a single-year statement of changes in net assets available for benefits and changes in accumulated plan benefits).
- The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements (paragraph .A91 provides guidance when the accumulated plan benefit information is presented in the notes to the financial statements).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion on the ERISA plan financial statements is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as a separate section in accordance with paragraphs .129–.130. The auditor has concluded that the information in the ERISA-required supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of XYZ Pension Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits and of accumulated plan benefits as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets available for benefits and accumulated plan benefits of XYZ Pension Plan as of December 31, 20X2 and 20X1, and the changes in its net assets available for benefits and changes in its accumulated plan benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than

for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

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

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

Supplemental Schedules Required by ERISA

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.[1]
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no limitations on the scope of the audit, and the auditor has not identified any material misstatements of the ERISA plan financial statements.
- The auditor has concluded that the ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. The auditor has concluded that the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, is presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. The information in the supplemental schedules related to assets held by and certified to by a qualified institution agreed to or is derived from, in all material respects, the

[1]Although not as common, an ERISA Section 103(a)(3)(C) audit may relate to the audit of a 103-12 entity as permitted by 29 CFR 2520.103-12. Accordingly, the wording in this illustrative report may need to be revised to fit the circumstances of the engagement.

information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.[2]

Opinion

In our opinion, based on our audits and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the accompanying financial statements related to assets held by[3] and certified to by a qualified institution agrees to, or is derived from, in all material

[2]If the note to the financial statements does not identify the names of the qualified certifying institutions and periods covered, then such information may be included in the auditor's report.

respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal

[3]This sentence may need to be modified when the certification is provided by an insurance entity, which provides benefits under the plan or holds plan assets.

control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify the title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by[4] and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[4]See footnote 3.

Illustration 4 — An Auditor's Report Containing a Qualified Opinion on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.[5]
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements have inadequate disclosures. The auditor has concluded that (*a*) it is not practicable to present the required information, and (*b*) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified ERISA Section 103(a)(3)(C) audit opinion. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- There are no limitations on the scope of the audit.
- The auditor has concluded that a qualified ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. The auditor has concluded that the qualification has an effect on the supplemental schedules because it is information also required by DOL Rules and Regulations for Reporting and Disclosure under

[5] See footnote 1.

ERISA. The auditor has included a discussion in the other-matter paragraph that describes the matter as discussed in paragraph .A151 of this section.

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.[6]

Qualified Opinion

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, based on our audits and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the accompanying financial statements related to assets held by[7] and certified to by a qualified institution agrees to, or is derived from, in all material

[6]See footnote 2.

respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Qualified Opinion

ABC 401(k) Plan's financial statements do not disclose [*describe the nature of the omitted information that is not practicable to present in the auditor's report*]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is

[7] See footnote 3.

not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Schedule [*identify supplemental schedule*] that accompanies ABC 401(k) Plan's financial statements does not disclose [*describe the nature of the omitted information*]. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, except for the effects of [*describe the nature of the omitted information*] as described in the Basis for Qualified Opinion section, on Schedule [*identify the schedule*]

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by[8] and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[8] See footnote 3.

Illustration 5 — An Auditor's Report Containing an Adverse Opinion on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under ERISA.[9]
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements are materially misstated. The material misstatement is deemed to be pervasive to the financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- There are no limitations on the scope of the audit.
- The auditor has concluded that an adverse ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. Because the auditor has issued

[9]See footnote 1.

an adverse ERISA Section 103(a)(3)(C) audit opinion, the auditor is precluded from issuing an opinion on the supplemental schedules.

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.[10]

Adverse Opinion

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly the net assets available for benefits of ABC 401(k) Plan as of December 31, 20X2 and 20X1, and the changes in net assets available for benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Adverse Opinion

As described in Note X, ABC 401(k) Plan [*describe the material misstatement of the financial statements*]. Under accounting principles generally accepted in the United States of America [*describe how the matter should have been accounted for in accordance with accounting*

[10]See footnote 2.

principles generally accepted in the United States of America]. The effects on the financial statements have not been determined.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — ERISA-Required Supplemental Schedules

The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Because of the significance of the matter described in the Basis for Adverse Opinion section of our report, it is inappropriate to and we do not express an opinion on the supplemental schedules referred to above.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion, Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence Because the Plan Has Not Maintained Sufficient Accounting Records, on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.[11]
- The auditor was engaged to perform an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no known material misstatements to the financial statements.
- The auditor was unable to obtain sufficient appropriate audit evidence for certain participant account balances that merged into the plan in 20XX. This is a limitation on the scope of the audit in accordance with section 705. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- The auditor has concluded that a disclaimer of opinion relating to the ERISA Section 103(a)(3)(C) audit is appropriate based on the audit evidence obtained.
- The auditor is precluded from communicating key audit matters when issuing a disclaimer of opinion.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. Because the auditor

[11]See footnote 1.

has disclaimed an opinion on the ERISA plan financial statements, the auditor is precluded from issuing an opinion on the supplemental schedules.

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We were engaged to perform audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.[12]

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of ABC 401(k) Plan. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

Basis for Disclaimer of Opinion

ABC 401(k) Plan does not have sufficient accounting records and supporting documents relating to certain participant account balances that merged into ABC 401(k) Plan in 20XX. Accordingly, we were unable to apply auditing procedures sufficient to determine the extent to which the accompanying financial statements may have been affected by these conditions.

[12]See footnote 2.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC 401(k) Plan's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC 401(k) Plan, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits.

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify the title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section, it is inappropriate to and we do not express an opinion on the supplemental schedules referred to above.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Revised, January 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138. As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Exhibit B — Implementation Guidance for ERISA Section 103(a)(3)(C) Audits

.A155

ERISA requires a statement of assets and liabilities of the plan to be displayed in comparative form. Typically, a plan will present comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits (see paragraph .A95 for typical plan financial statements by type of plan). Accordingly, when this SAS is adopted, the auditor may be asked to perform an ERISA Section 103(a)(3)(C) audit for the current year when the auditor disclaimed an opinion on the financial statements in the prior year.

Paragraphs .A123–.A125 explain that because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, use the ERISA Section 103(a)(3)(C) audit report, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented. Further, when issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

The following illustration contains example reports for when the auditor has adopted this SAS for the first time and is performing an ERISA Section 103(a)(3)(C) audit for the current year and updating their audit from the prior year.

Illustration B-1 — Auditor's Reports on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit in the Current Year (2020) and the Auditor Disclaimed an Opinion on the Financial Statements in the Prior Year (2019)

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit for the 2020 plan financial statements, as permitted by Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.[1]
- The audit is for a complete set of general purpose financial statements for a 401(k) plan subject to ERISA that is presenting comparative statements of net assets

[1]Although not as common, an ERISA Section 103(a)(3)(C) audit may relate to the audit of a 103-12 entity as permitted by 29 CFR 2520.103-12. Accordingly, the wording in this illustrative report may need to be revised to fit the circumstances of the engagement.

available for benefits and a single-year statement of changes in net assets available for benefits.

- The auditor performed an ERISA Section 103(a)(3)(C) audit as of and for the year ended December 31, 2020.
- The auditor disclaimed an opinion on the prior year financial statements (for the year ended December 31, 2019).
- The auditor is issuing two separate reports.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no limitations on the scope of the audit for the current year, and the auditor has not identified any material misstatements of the ERISA plan financial statements in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.
- The auditor has concluded that the ERISA Section 103(a)(3)(C) report is appropriate as of and for the year ended December 31, 2020 based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph for the year ended December 31, 2020.

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed an audit of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statement of net assets available for benefits as of December 31, 2020, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audit of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audit need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained a certification from a qualified institution as of and for the year ended December 31, 2020, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.[2]

Opinion

In our opinion, based on our audit and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the financial statements related to assets held by[3] and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[2]If the note to the financial statements does not identify the names of the qualified certifying institutions and periods covered, then such information may be included in the auditor's report.

[3]This sentence may need to be modified when the certification is provided by an insurance entity, which provides benefits under the plan or holds plan assets.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audit did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify the title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by[4] and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[4]See footnote 3.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

We were engaged to audit the accompanying statement of net assets available for benefits of ABC 401(k) Plan, as of December 31, 2019, and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the 2019 financial statement based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in Note X, which was certified by ABC Bank, the trustee of the Plan, except for comparing such information with the related information included in the financial statement. We have been informed by the plan administrator that the trustee (or custodian) holds the Plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian) as of December 31, 2019 that the information provided to the plan administrator by the trustee (or custodian) is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 2019 financial statement. Accordingly, we do not express an opinion on the 2019 financial statement.

Report on Form and Content in Compliance With DOL Rules and Regulations for 2019 Financial Statement

The form and content of the information included in the 2019 financial statement, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

AU-C Section 705

Modifications to the Opinion in the Independent Auditor's Report

(Supersedes SAS No. 122 section 705.)

Source: SAS No. 134; SAS No. 137; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to issue an appropriate report in circumstances in which, in forming an opinion in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This section also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion. In all cases, the reporting requirements in section 700 or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, apply; those requirements are not repeated in this section unless they are explicitly addressed or amended by the requirements of this section.

Types of Modified Opinions

.02 This section establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends on the following:

a. The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated

b. The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements (Ref: par. .A1)

.03 Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, and section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, address additional communications in the auditor's report that are not modifications to the auditor's opinion.

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objective

.05 The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary in the following circumstances:

a. The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated.

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Modified opinion. A qualified opinion, an adverse opinion, or a disclaimer of opinion on the financial statements.

Pervasive. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's 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
- regarding disclosures, are fundamental to users' understanding of the financial statements.

Requirements

Circumstances in Which a Modification to the Auditor's Opinion Is Required

.07 The auditor should modify the opinion in the auditor's report when

a. the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (Ref: par. .A2–.A8)

b. the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: par. .A9–.A13)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

.08 The auditor should express a qualified opinion in the following circumstances:

a. 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.

b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

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

Disclaimer of Opinion

.10 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. (Ref. par. .A14–.A15)

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement

.11 If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

.12 If management refuses to remove the limitation referred to in paragraph .11, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,[1] and, if appropriate, determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

.13 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications as follows:

a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor should qualify the opinion.

b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the severity of the situation, the auditor should

    i. disclaim an opinion on the financial statements or

    ii. withdraw from the audit, when practicable. (Ref: par. .A16–.A17)

.14 If the auditor decides to withdraw from the audit in accordance with paragraph .13*b*ii, before doing so, the auditor should communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: par. .A17)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

.15 When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report should not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts, or items of a financial statement (piecemeal opinion). To include such an unmodified opinion in the same report[2] in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: par. .A18–.A19)

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[1]Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[2]Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

Auditor Is Not Independent But Is Required by Law or Regulation to Report on the Financial Statements

.16 When the auditor is not independent but is required by law or regulation to report on the financial statements, the auditor should disclaim an opinion and should specifically state that the auditor is not independent. The auditor is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the auditor chooses to provide the reasons for the lack of independence, the auditor should include all the reasons therefor. (Ref: par. .A20)

Form and Content of the Auditor's Report When the Opinion Is Modified

Auditor's Opinion

.17 When the auditor modifies the audit opinion, the auditor should use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the "Opinion" section. (Ref: par. .A21–.A23)

Qualified Opinion

.18 When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor should state that, in the auditor's opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" section of the auditor's report, the accompanying financial statements present fairly, in all material respects, […] in accordance with [*the applicable financial reporting framework*]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase "except for the possible effects of the matters…" for the modified opinion. (Ref: par. .A24–.A25)

Adverse Opinion

.19 When the auditor expresses an adverse opinion, the auditor should state that, in the auditor's opinion, because of the significance of the matters described in the "Basis for Adverse Opinion" section of the auditor's report, the accompanying financial statements do not present fairly […] in accordance with [*the applicable financial reporting framework*].

Disclaimer of Opinion

.20 When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should do the following:

a. State that the auditor does not express an opinion on the accompanying financial statements.

b. State that, because of the significance of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

c. Amend the statement required by paragraph .25*b* of section 700, or paragraph .64*b* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Basis for Opinion

.21 When the auditor modifies the opinion on the financial statements, the auditor should, in addition to including the specific elements required by section 700 or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, do the following: (Ref: par. .A26)

a. Amend the heading "Basis for Opinion" required by paragraph .28 of section 700 or paragraphs .67 or .107 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate.

b. Within this section of the auditor's report, include a description of the matter giving rise to the modification.

.22 If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the "Basis for Opinion" section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should state that in the "Basis for Opinion" section. (Ref: par. .A27–.A28)

.23 If there is a material misstatement of the financial statements that relates to qualitative disclosures, the auditor should include an explanation of how the disclosures are misstated in the "Basis for Opinion" section.

.24 If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should do the following:

a. Discuss the omission of such information with those charged with governance.

b. Describe in the "Basis for Opinion" section the nature of the omitted information.

c. Include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: par. .A29–.A30)

.25 If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include the reasons for that inability in the "Basis for Opinion" section. (Ref. par. .A31)

.26 When the auditor expresses a qualified or an adverse opinion, the auditor should amend the statement required by paragraph .28*d* of section 700 or paragraphs .67 or .107 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion, to include the word "qualified" or "adverse," as appropriate.

.27 When the auditor disclaims an opinion on the financial statements, the auditor's report should not include the elements required by paragraphs .28*b* and .28*d* of section 700 or paragraphs .67*b* and .67*d* or .107*b* and .107*d* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. Those elements are

a. a reference to the section of the auditor's report where the auditor's responsibilities are described and

b. a statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

.28 Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should describe the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof, in the "Basis for Opinion" section. (Ref: par. .A32–.A33)

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements

.29 When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor should amend the description of the auditor's responsibilities required by paragraphs .35–.37 of section 700 or paragraphs .74–.76 or .115–.119 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to include only the following: (Ref: par. .A34)

a. A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report

b. A statement that, however, because of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements

c. A statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit, required by paragraph .28*c* of section 700 or paragraph .67*c* or .107*c* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable

Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements

.30 When the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, the auditor's report should not include a "Key Audit Matters" section in accordance with section 701.[3] (Ref: par. .A35–.A36) Also, when the auditor disclaims an opinion on the financial statements, the auditor's report should not include an "Other Information" section in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Communication With Those Charged With Governance

.31 When the auditor expects to modify the opinion in the auditor's report, the auditor should communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification. (Ref: par. .A37)

Application and Other Explanatory Material

Types of Modified Opinions (Ref: par. .02)

.A1 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, affects the type of opinion to be expressed:

	Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
Nature of Matter Giving Rise to the Modification	**Material but Not Pervasive-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

Circumstances in Which a Modification to the Auditor's Opinion Is Required

Nature of Material Misstatements (Ref: par. .07a)

.A2 Sections 700 and 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, require the auditor, in order to form an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.[4] This conclusion takes into account the auditor's evaluation of uncorrected

[3]Paragraphs .10–.12 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

[4]Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements* and paragraph .38 of section 703,*Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

misstatements, if any, on the financial statements, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*.

.A3 Section 450 defines a *misstatement* as a difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following:

- The appropriateness of the selected accounting policies
- The application of the selected accounting policies
- The appropriateness of the financial statement presentation, or the appropriateness or adequacy of disclosures in the financial statements

Appropriateness of the Selected Accounting Policies

.A4 Regarding the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise, for example, when

- the selected accounting policies are not consistent with the applicable financial reporting framework,
- the financial statements do not correctly describe an accounting policy relating to a significant item therein, or
- the financial statements do not represent or disclose the underlying transactions and events in a manner that achieves fair presentation.

.A5 Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. When the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements. If a change in accounting policy does not meet the conditions described in section 708, *Consistency of Financial Statements*, then a material misstatement of the financial statements may arise.

Application of the Selected Accounting Policies

.A6 Regarding the application of the selected accounting policies, material misstatements of the financial statements may arise

- when management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application).
- due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements

.A7 Regarding the appropriateness of the financial statement presentation or the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when the following occur:

- The financial statements do not include all the disclosures required by the applicable financial reporting framework.
- The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework.
- The financial statements do not provide the additional disclosures necessary to achieve fair presentation beyond disclosures specifically required by the applicable financial reporting framework.
- Information required to be presented in accordance with the applicable financial reporting framework is omitted either because a required statement (for example, a statement of cash flows) has not been included or because the information has not otherwise been disclosed in the financial statements.

Paragraph .A23 of section 450 provides further examples of material misstatements that may arise in qualitative disclosures.

.A8 Adequate disclosures relate to the presentation of the financial statements and the related notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

*Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: **par. .07b**)*

.A9 The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from the following:

- Circumstances beyond the control of the entity
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management

.A10 An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements in paragraphs .08*b* and .10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of risks of material misstatement due to fraud and consideration of engagement continuance.

.A11 Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

.A12 Examples of circumstances relating to the nature or timing of the auditor's work include the following:

- The entity is required to use the equity method of accounting for an investee, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories, and the auditor is unable to obtain sufficient appropriate audit evidence through other appropriate procedures, such as performing a rollback of inventory.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

.A13 Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include the following:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Determining the Type of Modification to the Auditor's Opinion

Effect of Uncertainties (Ref: par. .10)

.A14 Absence of the existence of information related to the outcome of an uncertainty does not necessarily lead to a conclusion that the audit evidence supporting management's assertion is not sufficient. Rather, the auditor's professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate.

.A15 In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on whether the financial statements as a whole are fairly presented in accordance with the applicable financial reporting framework due to the interaction and possible cumulative effects of the uncertainties.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement (Ref: par. .13)

.A16 The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion, and explain the scope limitation in the "Basis for Disclaimer of Opinion" section.

.A17 In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor who is appointed or elected to audit the financial statements of governmental entities. It may also be the case in circumstances in which the auditor is appointed to audit the financial statements covering a specific period or is appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period. In such circumstances, the auditor may consider it necessary to include an other-matter paragraph in the auditor's report.[5]

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: par. .15)

.A18 The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- In an initial audit, the expression of an unmodified opinion regarding the financial position and a disclaimer of opinion regarding the results of operations and cash flows, when relevant. In this case, the auditor has not disclaimed an opinion on the financial statements as a whole.
- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.

Considerations Specific to Audits of Governmental Entities

.A19 Because the auditor of a state or local governmental entity expresses an opinion or disclaims an opinion for each opinion unit,[6] an auditor's report in these circumstances may include an unmodified opinion with respect to one or more opinion units and a modified opinion for one or more other opinion units.

[5] Paragraphs .10–.11 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

[6] Paragraph .A6 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements (Ref: par. .16)

Considerations Specific to Governmental Entities

.A20 The nature of a government auditor's lack of independence may have a limited effect because the impairment may result from the government auditor's association with only a component of the overall governmental entity. A government auditor may determine that the lack of independence affects only one or more, but not all, of the governmental entity's opinion units, and in such circumstances, the auditor may disclaim an opinion on the affected opinion units while expressing unmodified, qualified, or adverse opinions on other opinion units. The more significant the affected opinion units are to the overall governmental entity, the more likely that it will be appropriate for the auditor to disclaim an opinion on the financial statements of the overall governmental entity.

Form and Content of the Auditor's Report When the Opinion Is Modified

Illustrative Auditor's Reports (Ref: par. .17)

.A21 Illustrations 1 and 3 in the exhibit to this section contain auditor's reports with qualified and adverse opinions, respectively, because the financial statements are materially misstated.

.A22 Illustration 4 in the exhibit contains an auditor's report with a qualified opinion because the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 6 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability to obtain sufficient appropriate audit evidence are both material and pervasive. The exhibits to other AU-C sections that include reporting requirements also include illustrations of auditor's reports with modified opinions.

Auditor's Opinion (Ref: par. .17)

.A23 Amending the heading required by paragraph .17 makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

Qualified Opinion (Ref: par. .18)

.A24 When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the "Opinion" section because these are not sufficiently clear or forceful. Because accompanying notes are part of the financial statements, wording such as "fairly presented, in all material respects, when read in conjunction with note 1" is likely to be misunderstood and would also not be appropriate.

.A25 When the auditor expresses a qualified opinion due to a scope limitation, paragraph .18 requires that the auditor state in the opinion paragraph that the qualification pertains to the possible effects of the matter on the financial statements and not to the scope limitation itself. Wording such as "In our opinion, except for the above-mentioned limitation on the scope of our audit…" bases the exception on the restriction itself rather than on the possible effects on the financial statements and, therefore, is unacceptable.

Basis for Opinion (Ref: par. .21, .22, .24, .28)

.A26 Consistency in the auditor's report helps promote users' understanding and helps users identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and the description of the reasons for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

.A27 An example of the financial effects of misstatements that the auditor may describe within the "Basis for Opinion" section in the auditor's report is the quantification of the effects on income before taxes, income taxes, net income, and equity if inventory is overstated. If such disclosures are made in a note to the financial statements, the "Basis for Opinion" section may refer to the note.

.A28 In considering the adequacy of disclosure, and in other aspects of the audit, the auditor uses information received in confidence from management. Without such confidence, the auditor would find it difficult to obtain information necessary to form an opinion on the financial statements. The "Confidential Client Information Rule" (ET sec. 1.700.001)[b] of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client. Accordingly, the auditor may not make available, without management's consent, information that is not required to be disclosed in the financial statements to comply with the applicable financial reporting framework.

.A29 *Practicable*, as used in the context of paragraphs .22 and .24*c*, means that the information is reasonably obtainable from management's accounts and records and that providing the information in the report does not require the auditor to assume the position of a preparer of financial information. For example, the auditor would not be expected to prepare a basic financial statement and include it in the auditor's report when management omits such information.

.A30 Disclosing the omitted information within the "Basis for Opinion" section would not be practicable if

- the information has not been prepared by management or the information is otherwise not readily available to the auditor or,
- in the auditor's judgment, the information would be unduly voluminous in relation to the auditor's report.

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[b]All ET sections can be found in AICPA *Professional Standards*.

.A31 When the auditor modifies the opinion due to an inability to obtain sufficient appropriate audit evidence, it is not appropriate for the scope of the audit to be explained in a note to the financial statements because the description of the audit scope is the responsibility of the auditor and not that of management.

.A32 An adverse opinion or a disclaimer of opinion relating to a specific matter described within the "Basis for Opinion" section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

.A33 The auditor may consider whether there is a need to describe in an emphasis-of-matter or other-matter paragraph[7] any other matters of which the auditor is aware that would not require a modification of the auditor's opinion.

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements (Ref: par. .29)

.A34 When the auditor disclaims an opinion on the financial statements, the following statements are better positioned within the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report, as illustrated in illustrations 5–6 of the exhibit to this section:

- The statement required by paragraph .28*a* of section 700 or paragraph .67*a* or .107*a* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, amended to state that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America
- The statement required by paragraph .28*c* of section 700 or paragraph .67*c* or .107*c* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about independence and other ethical responsibilities

Considerations When the Auditor Issues an Adverse Opinion or Disclaims an Opinion on the Financial Statements (Ref: par. .30)

.A35 Describing the reasons for the modification of the opinion within the "Basis for Opinion" section of the auditor's report provides information to users that is useful in understanding why the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements. Furthermore, describing these reasons may guard against inappropriate reliance on the financial statements. However, providing further details about the audit may overshadow the reasons for the modification of the opinion and may potentially be confusing to users.

.A36 When the auditor expresses an adverse opinion, the communication of any key audit matters other than the matters giving rise to the modified opinion may overshadow the

[7] See section 706.

fact that the financial statements as a whole are materially misstated. When the auditor disclaims an opinion, the communication of any key audit matters other than the matters giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances and would be inconsistent with the disclaimer of opinion on the financial statements as a whole. Similarly, it would not be appropriate for the auditor to make any statements about the auditor's consideration of the consistency of other information in an annual report with the financial statements. Accordingly, paragraph .30 of this section prohibits the inclusion of a "Key Audit Matters" section in the auditor's report when the auditor issues an adverse opinion or disclaims an opinion on the financial statements and also prohibits the inclusion of an "Other Information" section in the auditor's report when the auditor disclaims an opinion on the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Communication With Those Charged With Governance (Ref: par. .31)

.A37 Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables the following:

- The auditor to give notice to those charged with governance of the intended modification and the reasons (or circumstances) for the modification
- The auditor to seek the concurrence of those charged with governance regarding the facts of the matters giving rise to the expected modification, or to confirm matters of disagreement with management as such
- Those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations regarding the matters giving rise to the expected modification

Exhibit — Illustrations of Auditor's Reports With Modifications to the Opinion

.A38

Illustration 1 — An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Illustration 2 — An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Illustration 3 — An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Illustration 4 — An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

Illustration 5 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements

Illustration 7 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year

Illustration 8 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows

Illustration 1 — An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[1]

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all

[1]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of $XXX and $XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by $XXX and $XXX, and net income, income taxes, and stockholders' equity would have been reduced by $XXX, $XXX, and $XXX, and $XXX, $XXX, and $XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[2]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 2 — An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements have inadequate disclosures. The auditor has concluded that (*a*) it is not practicable to present the required information and (*b*) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[3]

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present

[3]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company's financial statements do not disclose [*describe the nature of the omitted information that is not practicable to present in the auditor's report*]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

[*Description of each key audit matter in accordance with section 701*, Communicating Key Audit Matters in the Independent Auditor's Report]

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[4]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[4]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements are materially misstated due to the nonconsolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Consolidated Financial Statements[5]

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

[5]The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly the financial position of ABC Company and its subsidiaries as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Adverse Opinion

As described in Note X, ABC Company has not consolidated the financial statements of subsidiary XYZ Company that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[6]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

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[6]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[*Date of the auditor's report*]

Illustration 4 — An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[7]

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present

[7] The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company's investment in XYZ Company, a foreign affiliate acquired during the year and accounted for under the equity method, is carried at $XXX on the balance sheet at December 31, 20X1, and ABC Company's share of XYZ Company's net income of $XXX is included in ABC Company's net income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company's investment in XYZ Company as of December 31, 20X1, and ABC Company's share of XYZ Company's net income for the year then ended because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[8]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[8]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 5 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment accounted for under the proportionate consolidation approach. The investment represents over 90 percent of the Company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion.
- The auditor concluded that it was unnecessary to include in the auditor's report specific amounts for the Company's proportional share of the assets, liabilities, income, and expenses of the joint venture investment because the investment represents over 90 percent of the Company's net assets, and that fact is disclosed in the auditor's report.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[9]

Disclaimer of Opinion

[9]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

Basis for Disclaimer of Opinion

ABC Company's investment in XYZ Company, a joint venture, is carried at $XXX on the Company's balance sheet, which represents over 90 percent of the Company's net assets as of December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary relating to the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the statements of changes in stockholders' equity and cash flows.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable at year-end because at that time the auditor had not been engaged. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's opinion contains a disclaimer of opinion.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[10]

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

[10]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We were not engaged as auditors of ABC Company until after December 31, 20X1, and, therefore, did not observe the counting of physical inventories at the beginning or end of the year. We were unable to satisfy ourselves by other auditing procedures concerning the inventory held at December 31, 20X1, which is stated in the balance sheet at $XXX. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous misstatements in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the misstatements. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of $XXX at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statements of income, changes in stockholders' equity, and cash flows.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 7 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Certain lease obligations have been excluded from the financial statements in the current year. The effect of the exclusion is material but not pervasive. The auditor expressed an unmodified opinion in the prior year and is expressing a modified opinion (qualified opinion) in the current year.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[11]

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects on the accompanying 20X1 financial statements of not capitalizing certain lease obligations as described in the Basis for Qualified Opinion section of our report, the financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of

[11]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion on the 20X1 Financial Statements

ABC Company has excluded, from property and debt in the accompanying 20X1 balance sheet, certain lease obligations that were entered into in 20X1 that, in our opinion, should be capitalized in accordance with accounting principles generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by $XXX, long-term debt by $XXX, and retained earnings by $XXX as of December 31, 20X1, and net income and earnings per share would be increased (decreased) by $XXX and $XXX, respectively, for the year then ended.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion on the 20X1 financial statements and for our opinion on the 20X0 financial statements.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[12]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[12]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 8 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to observe the physical inventory as of December 31, 20X0, because at that time the auditor had not been engaged. Accordingly, the auditor was unable to obtain sufficient appropriate audit evidence regarding the net income and cash flows for the year ended December 31, 20X1. The effects of the inability to obtain sufficient appropriate audit evidence are deemed material and pervasive.
- In accordance with paragraph .A26 of section 700, the opinion does not separately refer to the statement of changes in stockholders' equity because changes in stockholders' equity accounts are considered part of the presentation of financial position, results of operations, and cash flows.
- The auditor expressed an unmodified opinion on the December 31, 20X2 and 20X1, balance sheets and a disclaimer of opinion on the 20X1 statements of income, changes in stockholders' equity, and cash flows.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[13]

Opinion

[13]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying balance sheets of ABC Company as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion on 20X1 Operations and Cash Flows

We do not express an opinion on the accompanying results of operations and cash flows for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the balance sheets as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2.

Basis for Disclaimer of Opinion on 20X1 Operations and Cash Flows

We did not observe the taking of the physical inventory as of December 31, 20X0, because that date was prior to our engagement as auditors for ABC Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 20X0, enter into the determination of net income and cash flows for the year ended December 31, 20X1.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about

ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[14]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[14]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

AU-C Section 706

Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report

(Supersedes SAS No. 122 section 706.)

Source: SAS No. 134; SAS No. 137; SAS No. 140; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Introduction

Scope of This Section

.01 This section addresses additional communications in the auditor's report when the auditor considers it necessary to

a. draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements (emphasis-of-matter paragraph); or

b. draw users' attention to any matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report (other-matter paragraph).

.02 The communication of key audit matters is not required by section 700, *Forming an Opinion and Reporting on Financial Statements*, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, or section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. However, when the auditor is engaged to communicate key audit matters, this section addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this section. (Ref: par. .A1)

.03 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, and section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, addresses communication in the auditor's report relating to going concern and other information, respectively. (Ref. par. .A2) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.04 Exhibit B, "List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs," and exhibit C, "List of AU-C Sections Containing Requirements for Other-Matter Paragraphs," of this section identify AU-C sections containing specific requirements for the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report. When an emphasis-of-matter or other-matter paragraph is required, the requirements in this section regarding the form of such paragraphs apply. (Ref: par. .A3)

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objective

.06 The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to the following:

a. A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements

b. As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report

Definitions

.07 For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

Emphasis-of-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers 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.

Other-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to 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.

Requirements

Emphasis-of-Matter Paragraphs in the Auditor's Report

.08 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 following apply: (Ref: par. .A4–.A5)

a. The auditor would not be required to modify the opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, as a result of the matter.

b. When section 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A1)

.09 When the auditor includes an emphasis-of-matter paragraph in the auditor's report, the auditor should do the following:

a. Include the paragraph within a separate section of the auditor's report with an appropriate heading. When key audit matters are communicated in the auditor's report, the heading should include the term "Emphasis of Matter." (Ref. par. .A6)

b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.

c. Indicate that the auditor's opinion is not modified with respect to the matter emphasized. (Ref: par. .A7–.A8, .A14–.A15)

Other-Matter Paragraphs in the Auditor's Report

.10 If the auditor considers it necessary to communicate a matter other than those that are 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 include an other-matter paragraph in the auditor's report, provided that, when section 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A9–.A12)

.11 When the auditor includes an other-matter paragraph in the auditor's report, the auditor should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. .A13–.A15)

Communication With Those Charged With Governance

.12 If the auditor expects to include an emphasis-of-matter or other-matter paragraph in the auditor's report, the auditor should communicate with those charged with governance regarding this expectation and the wording of the paragraph. (Ref: par. .A16)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.04)

The Relationship Between Emphasis-of-Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: par. .02–.04, .08b)

.A1 *Key audit matters* are defined in section 701 as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance, which include significant findings from the audit of the financial statements of the current period.[1] Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in the audited financial statements. When section 701 applies, the use of emphasis-of-matter paragraphs is not a substitute for a description of individual key audit matters.

.A2 If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor is required to include a separate section in the auditor's report under the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern."[2] If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with this section, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.[3]

.A3 The AU-C sections identified in exhibits B and C require the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report relating to certain matters. The nature of these matters is such that they are brought to the attention of users of the auditor's report in all instances rather than at the discretion of the auditor. The explanatory language provided by such required paragraphs achieves the

[1] Paragraph .14 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[2] Paragraph .24 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

[3] Paragraphs .A54–.A56 of section 570.

same objective as an emphasis-of-matter or other-matter paragraph that is included based on the professional judgment of the auditor (that is, to provide additional communication to the users of the auditor's report). Therefore, the auditor follows the requirements in this section regarding the form of these required paragraphs.

Emphasis-of-Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis-of-Matter Paragraph May Be Necessary (Ref: par. .08)

.A4 In addition to the required emphasis-of-matter paragraphs listed in exhibit B, the following are examples of circumstances in which the auditor may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report[4]
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position or results of operations
- Significant transactions with related parties

.A5 Paragraph .08 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure.

Including an Emphasis-of-Matter Paragraph in the Auditor's Report (Ref: par. .09)

.A6 The term "Emphasis of Matter" is required to be included in the heading when key audit matters are communicated to clearly differentiate the matter in the emphasis-of-matter paragraph from those included in the Key Audit Matters section of the auditor's report. The auditor may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter — Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph.

.A7 The inclusion of an emphasis-of-matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis-of-matter paragraph is not a substitute for the following:

- A modified opinion in accordance with section 705 when required by the circumstances of a specific audit engagement

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[4]Paragraph .07 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- Disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- Reporting in accordance with section 570 when, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the auditor is required to include a separate section in the auditor's report (see paragraph .A2)

.A8 Paragraphs .A14–.A15 provide further guidance on the placement of emphasis-of-matter paragraphs in particular circumstances.

Other-Matter Paragraphs in the Auditor's Report (Ref: par. .10–.11)

Circumstances in Which an Other-Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

.A9 When the auditor is unable to withdraw from an engagement, even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,[5] the auditor may consider it necessary to include an other-matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

.A10 Law, regulation, or generally accepted practice may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. When the "Other Matter" section includes more than one matter that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, it may be helpful to use different subheadings for each matter.

.A11 An other-matter paragraph does not address circumstances in which the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under GAAS (see the section "Other Reporting Responsibilities" in section 700) or when the auditor has been asked to perform and report on additional specified procedures or to express an opinion on specific matters.

Reporting on More Than One Set of Financial Statements

.A12 An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards

[5] See paragraph .13 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, for a discussion of this circumstance.

promulgated by the International Accounting Standards Board) and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an other-matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Including an Other-Matter Paragraph in the Auditor's Report

.A13 The content of an other-matter paragraph clearly reflects that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the auditor is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to confidentiality of information). An other-matter paragraph also does not include information that is required to be provided by management.

Placement of Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Auditor's Report (Ref: par. .09, .11)

.A14 This section does not specify the placement of an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report. Rather, the placement depends on the nature of the information to be communicated and the auditor's judgment about the relative significance of such information to intended users compared to other elements required to be reported in accordance with section 700. The following are examples of considerations related to the placement of emphasis-of-matter and other-matter paragraphs:

- *Emphasis-of-Matter Paragraphs.* When a "Key Audit Matters" section is presented in the auditor's report, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter," such as "Emphasis of Matter — Subsequent Event," to differentiate the emphasis-of-matter paragraph from the individual matters described in the "Key Audit Matters" section.
- *Other-Matter Paragraphs.*
  - — When a "Key Audit Matters" section is presented in the auditor's report and an other-matter paragraph is also considered necessary, the auditor may add further context to the heading "Other Matter," such as "Other Matter — Scope of the Audit," to differentiate the other-matter paragraph from the individual matters described in the "Key Audit Matters" section.
  - — When an other-matter paragraph is included to draw users' attention to a matter relating to other reporting responsibilities addressed in the auditor's report, the paragraph may be included in the section "Report on Other Legal and Regulatory Requirements."

— When it is relevant to all the auditor's responsibilities or to users' understanding of the auditor's report, the other-matter paragraph may be included as a separate section following the sections "Report on the Audit of the Financial Statements" and "Report on Other Legal and Regulatory Requirements."

.A15 Illustration 2 in exhibit A shows the interaction between the "Key Audit Matters" section, an emphasis-of-matter paragraph, and an other-matter paragraph when all are presented in the auditor's report.

Communication With Those Charged With Governance (Ref. par. .12)

.A16 The auditor's communication with those charged with governance required by paragraph .12 enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor when necessary. As discussed in paragraph .A50 of section 260, *The Auditor's Communication With Those Charged With Governance*, certain matters may be important to communicate prior to the issuance of the auditor's report. When the inclusion of an other-matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

Exhibit A — Illustrations of Auditor's Reports With Emphasis-of-Matter or Other-Matter Paragraphs

.A17

Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 2 — An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Illustration 3 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Illustration 4 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes an emphasis-of-matter paragraph.[1]
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects the financial position of ABC Company as of December 31, 20X1, and the results

[1]Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

[2]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, ABC Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[3]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[3] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 2 — An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.[1]
- The prior period financial statements were audited by a predecessor auditor.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

[1]Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

[2]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter[3]

As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[*Description of each key audit matter in accordance with section 701*, Communicating Key Audit Matters in the Independent Auditor's Report]

Other Matter

The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.

Responsibilities of Management for the Financial Statements

[3]As noted in paragraph .A14, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[4]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

[4]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[*Reporting in accordance with the reporting requirements in section 720,* The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor's report on the prior period financial statements expressed an adverse opinion due to identified departures from accounting principles generally accepted in the United States of America that resulted in the financial statements being materially misstated. The entity has elected to change its method of accounting for the matters that gave rise to the adverse opinion in the prior period and has restated the prior period financial statements. Therefore, the auditor has expressed an unmodified opinion on the comparative financial statements.
- The auditor's report includes an other-matter paragraph indicating that the updated report on the financial statements of the prior period contains an opinion different from the opinion previously expressed, as required by section 700. Although the entity changed its method of accounting for the matters that gave rise to the adverse opinion in the prior period and corrected the material misstatement in the 20X0 financial statements, the principal objective of the communication in the other-matter paragraph is to draw users' attention to the change in the auditor's opinion on the prior period financial statements. The other-matter paragraph refers to the change in accounting principle and the related disclosure in the financial statements. Therefore, the other-matter paragraph also meets the objective of communicating the change in accounting principle as required by section 708, *Consistency of Financial Statements*, and a separate emphasis-of-matter paragraph is not considered necessary.[1]
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

[1]Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other Matter

In our report dated March 1, 20X1, we expressed an opinion that the 20X0 financial statements did not fairly present the financial position, results of operations, and cash flows of ABC Company in accordance with accounting principles generally accepted in the United States of America because of two departures from such principles: (1) ABC Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) ABC Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 20X0 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the restated 20X0 financial statements, as presented herein, is different from that expressed in our previous report.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United

[2]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[3]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

[3]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 4 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes a qualified opinion and also includes an emphasis-of-matter paragraph.[1]
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

[1]Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

[2]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company has stated inventories at cost in the accompanying balance sheet. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of $XXX would have been required as of December 31, 20X1. Accordingly, cost of sales would have been increased by $XXX and net income, income taxes, and stockholders' equity would have been reduced by $XXX, $XXX, and $XXX, as of and for the year ended December 31, 20X1, respectively.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Emphasis of Matter — Litigation

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[3]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[3]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Exhibit B — List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs (Ref: par. .04)

.A18 This exhibit identifies paragraphs in other AU-C sections that require the auditor to include an emphasis-of-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16*c* of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .08–.09 and .11–.13 of section 708, *Consistency of Financial Statements*
- Paragraphs .19 and .21 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

Exhibit C — List of AU-C Sections Containing Requirements for Other-Matter Paragraphs (Ref: par. .04)

.A19 This exhibit identifies paragraphs in other AU-C sections that require the auditor to include an other-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16*c* of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .55–.56 and .58–.59 of section 700, *Forming an Opinion and Reporting on Financial Statements*
- Paragraphs .53, .92–.93, .95–.96, .121, and .133 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*
- Paragraph .20 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
- Paragraph .13 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- Paragraph .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*

[Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 708

Consistency of Financial Statements

Source: SAS No. 122; SAS No. 136.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's evaluation of the consistency of the financial statements between periods, including changes to previously issued financial statements and the effect of that evaluation on the auditor's report on the financial statements.

Effective Date

.02 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objectives

.03 The objectives of the auditor are to

a. evaluate the consistency of the financial statements for the periods presented and

b. communicate appropriately in the auditor's report when the comparability of 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.

Definition

.04 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Current period. The most recent period upon which the auditor is reporting.

Requirements

Evaluating Consistency

.05 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. (Ref: par. .A1)

.06 The periods included in the auditor's evaluation of consistency depend on the periods covered by the auditor's opinion on the financial statements. When the auditor's opinion covers only the current period, the auditor should evaluate whether the current-period financial statements are consistent with those of the preceding period, regardless of whether financial statements for the preceding period are presented. When the auditor's opinion covers two or more periods, the auditor should evaluate consistency between such periods and the consistency of the earliest period covered by the auditor's opinion with the period prior thereto, if such prior period is presented with the financial statements being reported upon. The auditor also should evaluate whether the financial statements for the periods being reported upon are consistent with previously issued financial statements for the relevant periods. (Ref: par. .A2–.A3)

Change in Accounting Principle

.07 The auditor should evaluate a change in accounting principle to determine whether (Ref: par. .A4–.A6)

a. the newly adopted accounting principle is in accordance with the applicable financial reporting framework,

b. the method of accounting for the effect of the change is in accordance with the applicable financial reporting framework,

c. the disclosures related to the accounting change are appropriate and adequate, and

d. the entity has justified that the alternative accounting principle is preferable.

.08 If the auditor concludes that the criteria in paragraph .07 have been met, and the change in accounting principle has a material effect on the financial statements, the auditor should include an emphasis-of-matter paragraph[1] in the auditor's report that describes the change in accounting principle and provides a reference to the entity's disclosure. If the criteria in paragraph .07 are not met, the auditor should evaluate whether the accounting change results in a material misstatement and whether the auditor should modify the opinion accordingly.[2] (Ref: par. .A7–.A9)

.09 The auditor should include an emphasis-of-matter paragraph relating to a change in accounting principle in reports on financial statements in the period of the change, and in subsequent periods, until the new accounting principle is applied in all periods presented. If the change in accounting principle is accounted for by retrospective application to the financial statements of all prior periods presented, the emphasis-of-matter paragraph is needed only in the period of such change.

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[1]Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

[2]See section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.10 The auditor should evaluate and report on a change in accounting estimate that is inseparable from the effect of a related change in accounting principle like other changes in accounting principle, as required by paragraphs .08–.09. (Ref: par. .A10)

.11 When a change in the reporting entity results in financial statements that, in effect, are those of a different reporting entity, the auditor should include an emphasis-of-matter paragraph in the auditor's report that describes the change in the reporting entity and provides a reference to the entity's disclosure, unless the change in reporting entity results from a transaction or event. The requirements in paragraph .09 also apply. (Ref: par. .A11)

.12 If an entity's financial statements contain an investment accounted for by the equity method, the auditor's evaluation of consistency should include consideration of the investee. If the investee makes a change in accounting principle that is material to the investing entity's financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report to describe the change in accounting principle. The requirements in paragraph .09 also apply.

Correction of a Material Misstatement in Previously Issued Financial Statements

.13 The auditor should include an emphasis-of-matter paragraph in the auditor's report when there are adjustments to correct a material misstatement in previously issued financial statements. The auditor should include this type of emphasis-of-matter paragraph in the auditor's report when the related financial statements are restated to correct the prior material misstatement. The paragraph need not be repeated in subsequent periods. (Ref: par. .A12–.A13)

.14 The emphasis-of-matter paragraph should include

a. a statement that the previously issued financial statements have been restated for the correction of a material misstatement in the respective period and

b. a reference to the entity's disclosure of the correction of the material misstatement. (Ref: par. .A14)

.15 If the financial statement disclosures relating to the restatement to correct a material misstatement in previously issued financial statements are not adequate, the auditor should address the inadequacy of disclosure as described in section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Change in Classification

.16 The auditor should evaluate a material change in financial statement classification and the related disclosure to determine whether such a change is also either a change in accounting principle or an adjustment to correct a material misstatement in previously issued financial statements. If so, the requirements of paragraphs .07–.15 apply. (Ref: par. .A15–.A16)

Application and Other Explanatory Material

Evaluating Consistency (Ref: par. .05–.06)

.A1 Unless the auditor's report explicitly states otherwise, the auditor's report implies that the auditor is satisfied that the comparability of financial statements between periods has not been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements. There may be no effect on comparability between or among periods because either (*a*) no change in an accounting principle has occurred, or (*b*) there has been a change in an accounting principle or in the method of application, but the effect of the change on the comparability of the financial statements is not material. When no material effect on comparability results from a change in accounting principle or an adjustment to previously issued financial statements, the auditor need not refer to consistency in the auditor's report.

.A2 The periods covered in the auditor's evaluation of consistency depend on the periods covered by the auditor's opinion on the financial statements. If an entity presents comparative financial statements and has a change in auditors in the current year, the auditor evaluates consistency between the year covered by the auditor's opinion and the immediately preceding year in accordance with the requirements in paragraph .06.

.A3 When an entity accounts for a change in accounting principle by applying the principle to one or more prior periods that were included in previously issued financial statements, as if that principle had always been used (commonly referred to as *retrospective application*), the financial statements presented generally will be consistent. However, the previous periods' financial statements presented with the current period's financial statements will reflect the change in accounting principle and, therefore, will appear different from those previous periods' financial statements on which the auditor previously reported. The evaluation required by paragraph .06 encompasses previously issued financial statements for the relevant periods.

Change in Accounting Principle (Ref: par. .07)

.A4 A change in accounting principle is a change from one accounting principle in accordance with the applicable financial reporting framework to another accounting principle in accordance with the applicable financial reporting framework when (1) two or more accounting principles apply or (2) the accounting principle formerly used is no longer in accordance with the applicable financial reporting framework. A change in the method of applying an accounting principle also is considered a change in accounting principle.

.A5 The applicable financial reporting framework usually sets forth the method of accounting for the effects of a change in accounting principle and the related disclosures.

.A6 The issuance of an accounting pronouncement that requires use of a new accounting principle, interprets an existing principle, expresses a preference for an accounting principle, or rejects a specific principle is sufficient justification for a change in accounting principle, as long as the change in accounting principle is made in accordance with the applicable financial reporting framework.

Reporting on Changes in Accounting Principles (Ref: par. .08–.11)

.A7 The following is an example of an emphasis-of-matter paragraph for a change in accounting principle resulting from the adoption of a new accounting pronouncement:

> *Emphasis of Matter*
>
> As discussed in Note X to the financial statements, in [*insert year(s) of financial statements that reflect the accounting method change*], the entity adopted new accounting guidance [*insert description of new accounting guidance*]. Our opinion is not modified with respect to this matter.

.A8 The following is an example of an emphasis-of-matter paragraph when the entity has made a voluntary change in accounting principle (that is, other than a change due to the adoption of a new accounting pronouncement).

> *Emphasis of Matter*
>
> As discussed in Note X to the financial statements, the entity has elected to change its method of accounting for [*describe accounting method change*] in [*insert year(s) of financial statements that reflect the accounting method change*]. Our opinion is not modified with respect to this matter.

.A9 If a change in accounting principle does not have a material effect on the financial statements in the current year but the change is expected to have a material effect in later years, the auditor is not required to recognize the change in the auditor's report in the current year. The applicable financial reporting framework may include a requirement for the entity to disclose such situations in the notes to the financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, and section 705 require the auditor to evaluate the appropriateness and adequacy of disclosures in connection with forming an opinion and reporting on the financial statements.[3] [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A10 Paragraph .10 requires the auditor to evaluate and report on a change in accounting estimate that is inseparable from the effect of a related change in accounting principle like other changes in accounting principle. It is sometimes difficult to differentiate between a change in an accounting estimate and a change in an accounting principle because the change in accounting estimate may be inseparable from the effect of a related change in

[3]Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*, paragraph .40 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and paragraphs .07 and .A7 of section 705. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

accounting principle. For example, when a change is made to the method of depreciation of an asset to reflect a change in the estimated future benefit of the asset or the pattern of consumption for those benefits, such change in accounting may be inseparable from a change in estimate.

Change in Reporting Entity

.A11 A change in reporting entity that results from a transaction or event, such as the creation, cessation, or complete or partial purchase or disposition of a subsidiary or other business unit, does not require recognition in the auditor's report. Examples of a change in the reporting entity that is not a result of a transaction or event include

a. presenting consolidated or combined financial statements in place of financial statements of individual entities.

b. changing specific subsidiaries that make up the group of entities for which consolidated financial statements are presented.

c. changing the entities included in combined financial statements.

Correction of a Material Misstatement in Previously Issued Financial Statements (Ref: par. .13–.14)

.A12 A change from an accounting principle that is not in accordance with the applicable financial reporting framework to one that is in accordance with the applicable financial reporting framework is a correction of a misstatement.

.A13 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities when adjustments have been made to correct a material misstatement in previously issued financial statements.

Reporting on a Correction of a Material Misstatement in Previously Issued Financial Statements

.A14 The following is an example of an emphasis-of-matter paragraph when there has been a correction of a material misstatement in previously issued financial statements:

Emphasis of Matter

As discussed in Note X to the financial statements, the 20X2 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Change in Classification (Ref: par. .16)

.A15 Changes in classification in previously issued financial statements do not require recognition in the auditor's report unless the change represents the correction of a material misstatement or a change in accounting principle. For example, certain reclassifications in previously issued financial statements, such as reclassifications of debt from long-term to short-term or reclassifications of cash flows from the operating activities category to the financing activities category, might occur because those items were classified incorrectly in the previously issued financial statements. In such situations, the reclassification also is the correction of a misstatement.

.A16 In some cases, changes in classification in previously issued financial statements may result from changes in the entity's business or operating structure. The auditor may need to obtain a further understanding of the underlying rationale for such reclassifications to determine whether the requirements of paragraph .16 apply.

AU-C Section 720

The Auditor's Responsibilities Relating to Other Information Included in Annual Reports

Source: SAS No. 137; SAS No. 141; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to other information, whether financial or nonfinancial information (other than financial statements and the auditor's report thereon), included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose.

.02 This section also may be applied, and adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention. (Ref: par. .A1–.A3)

.03 This section is written in the context of an audit of financial statements by an independent auditor. Accordingly, the objectives of the auditor in this section are to be understood in the context of the overall objectives of the auditor as stated in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.[1] The requirements in the standards are designed to enable the auditor to achieve the objectives specified in the standards, and thereby the overall objectives of the auditor. The auditor's opinion on the financial statements does not cover the other information, nor does this section require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.

.04 This section requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor's report thereon.

.05 Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about amounts or other items in the financial statements and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may include nonfinancial information.

.06 The auditor's responsibilities relating to other information, other than applicable reporting requirements, apply regardless of whether the other information is obtained by the auditor prior to or after the date of the auditor's report.

.07 The auditor's responsibilities under this section do not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information.

.08 Law or regulation may impose additional obligations on the auditor in relation to other information that are beyond the scope of this section.

.09 This section does not apply to supplemental information addressed by section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, or required supplementary information addressed by section 730, *Required Supplementary Information*. (Ref: par. .A2)

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

[1] Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Objectives

.11 The objectives of the auditor, having read the other information, are as follows:

a. To consider whether a material inconsistency exists between the other information and the financial statements

b. To remain alert for indications that

   i. a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit or

   ii. a material misstatement of fact exists or the other information is otherwise misleading

c. To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated

d. To report in accordance with this section

Definitions

.12 For purposes of the auditing standards, the following terms have the meanings attributed:

Annual report. A document, or combination of documents, typically prepared on an annual basis by management or those charged with governance in accordance with law, regulation, or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains, accompanies, or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public. (Ref: par. .A4–.A10)

Misstatement of the other information. A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading. (Ref: par. .A11–.A12)

Other information. Financial or nonfinancial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. (Ref: par. .A13)

Requirements

Obtaining the Other Information

.13 The auditor should do the following: (Ref: par. .A14–.A24)

a. Through discussion with management, determine and obtain management's written acknowledgment regarding which document or documents comprise the annual report and the entity's planned manner and timing of the issuance of such documents.

b. Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the document or documents comprising the annual report.

c. When some or all the documents determined in (*a*) will not be available until after the date of the auditor's report on the financial statements, request management to provide a written representation that the final version of the documents will be provided to the auditor when available, and prior to the document's issuance by the entity, such that the auditor can complete the procedures required by this section. (Ref: par. .A23–.A24)

.14 If the auditor becomes aware that the entity did not provide the auditor with the final version of documents determined in accordance with paragraph .13*a* to be part of the annual report prior to the issuance of those documents to third parties, the auditor should take appropriate action. (Ref: par. .A25)

Communication With Those Charged With Governance

.15 The auditor should communicate with those charged with governance the auditor's responsibility with respect to other information, the procedures performed related to the other information, and the results.

Reading and Considering the Other Information

.16 The auditor should read the other information and consider whether a material inconsistency exists between the other information and the financial statements. As the basis for this consideration, to evaluate their consistency, the auditor should compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements) with such amounts or other items in the financial statements. (Ref: par. .A26–.A32)

.17 While reading the other information in accordance with paragraph .16, the auditor should remain alert for indications that (Ref: par. .A33–.A42)

a. a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit.

b. a material misstatement of fact exists or the other information is otherwise misleading.

.18 The auditor is not responsible for searching for omitted information or for the completeness of the other information.

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated

.19 If the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor should discuss the matter with management and, if necessary, perform other procedures to conclude the following: (Ref: par. .A43–.A47)

a. Whether a material misstatement of the other information exists

b. Whether a material misstatement of the financial statements exists

c. Whether the auditor's understanding of the entity and its environment needs to be updated

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

.20 If the auditor concludes that a material misstatement of the other information exists, the auditor should request management to correct the other information and

a. if management agrees to make the correction, determine that the correction has been made.

b. if management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made.

.21 If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance, the auditor should (Ref: par. .A48)

a. consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the material misstatement in the auditor's report (see paragraph .24*c*ii); (Ref: par. .A49)

b. withhold the auditor's report; or (Ref: par. .A51)

c. withdraw from the engagement, when withdrawal is possible under applicable law or regulation. (Ref: par. .A50–.A51)

.22 If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor should do the following:

a. If the other information is corrected, perform the procedures necessary in the circumstances. (Ref: par. .A52)

b. If the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations to seek to have the uncorrected material misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report. (Ref: par. .A53–.A54)

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated

.23 If, as a result of performing the procedures in paragraphs .16–.18, the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, the auditor should respond appropriately in accordance with other relevant AU-C sections. (Ref: par. .A55)

Reporting

.24 At the date of the auditor's report, when the auditor has obtained all the other information, the composition of which was determined through discussion with management and for which the auditor obtained management's written acknowledgment (pursuant to paragraph .13*a*), the auditor should include a separate section in the auditor's report on the financial statements with the heading "Other Information" or other appropriate heading. The "Other Information" section in the auditor's report on the financial statements should include the following: (Ref: par. .A56)

a. A statement that management is responsible for the other information

b. An identification of other information and a statement that the other information does not include the financial statements and the auditor's report thereon

c. A statement that the auditor's opinion on the financial statements does not cover the other information and that the auditor does not express an opinion or any form of assurance thereon

d. A statement that, in connection with the audit of the financial statements, the auditor is responsible to read the other information and consider whether a material inconsistency exists between the other information and the financial statements or the other information otherwise appears to be materially misstated

e. A statement that, if, based on the work performed, the auditor concludes that an uncorrected material misstatement of the other information exists, the auditor is required to describe it in the auditor's report

f. If the auditor has concluded that an uncorrected material misstatement of the other information exists, a statement that the auditor has concluded that an uncorrected material misstatement of the other information exists and a description of it in the auditor's report

.25 When the auditor expresses a qualified or adverse opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, the auditor should consider the implications of the matter giving rise to the modification of opinion for the statement required in paragraph .24*f* of this section. (Ref: par. .A57–.A61)

Documentation

.26 In addressing the requirements in section 230, *Audit Documentation*,[2] as those requirements apply to this section, the auditor should include the following in the audit documentation:

a. The procedures performed under this section

b. The final version of the other information on which the auditor has performed the work required under this section

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02 and .09)

.A1 In instances in which the auditor applies this section to other documents to which the auditor, at management's request, devotes attention, the requirements of this section are applicable, adapted as necessary in the circumstances.

.A2 Other AU-C sections provide requirements and guidance with respect to information in certain documents other than annual reports. For example, section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*; section 945, *Auditor Involvement With Exempt Offering Documents*; and Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (sec. 703).[3]

.A3 This section also addresses other information for which a designated accounting standard setter[4] has issued standards or guidance regarding the format to be used and content to be included when such information is voluntarily presented in an annual report — for example, GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*.

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[2]Paragraphs .08–.11 of section 230, *Audit Documentation*.

[3]Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (sec. 703), is effective for audits of financial statements for periods ending on or after December 15, 2021.

[4]*Designated accounting standards setter* is defined in paragraph .04 of section 730, *Required Supplementary Information*.

Definitions

Annual Report (Ref: par. .12)

.A4 Law, regulation, or custom may define the content of an annual report and the name by which it is to be referred.

.A5 An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.

.A6 In some cases, an entity's annual report may be a single document and referred to by the title "Annual Report" or by some other title. In other cases, law, regulation, or custom may require the entity to report to owners (or similar stakeholders) information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (that is, an annual report) by way of a single document or by way of two or more separate documents that, in combination, serve the same purpose.

.A7 An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document (or combination of documents) may meet the definition of an *annual report*, irrespective of the manner in which it is made available to users.

.A8 An annual report is different in nature, purpose, and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or a report prepared to comply with a specific regulatory reporting objective (even when such a report is required to be publicly available). Examples of reports that, when issued as stand-alone documents, are not typically part of the combination of documents that comprise an annual report (subject to law, regulation, or custom), and, therefore, are not other information within the scope of this section, include the following:

- IRS Form 990, *Return of Organization Exempt From Income Tax*
- IRS Form 5500, *Annual Return/Report of Employee Benefit Plan*
- Annual statement filed with National Association of Insurance Commissioners
- Separate industry or regulatory reports (for example, capital adequacy reports), such as those prepared in the banking, insurance, and pension industries
- Corporate social responsibility reports
- Sustainability reports
- Diversity and equal opportunity reports
- Product responsibility reports
- Labor practices and working conditions reports
- Human rights reports

.A9 Though a document may be referred to as an *annual report*, such document may not meet the definition of an *annual report* for purposes of this section.

Considerations Specific to Governmental Entities

.A10 The term *annual reports of governments* is intended to include annual comprehensive financial reports or other annual financial reports that include the government's financial statements and the auditor's report thereon.

Misstatement of the Other Information (Ref: par. .12)

.A11 A misstatement of the other information may be

- an inconsistency;
- a misstatement of fact; or
- information that is otherwise misleading, including because it omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information.

An inconsistency exists when other information conflicts with information contained in the financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements. A misstatement of fact exists when other information that is unrelated to matters appearing in the financial statements is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the annual report. Information that is otherwise misleading, including because it omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information, could result in a material misstatement of the other information.

.A12 The concept of materiality may be discussed in a framework applicable to the other information and, if so, such a framework may provide a frame of reference for the auditor in making judgments about materiality under this section. In many cases, however, there may be no applicable framework that includes a discussion of the concept of materiality as it applies to the other information. In such circumstances, the following characteristics provide the auditor with a frame of reference in determining if a misstatement of the other information is material:

- Materiality is considered in the context of the common information needs of users as a group. The users of the other information are expected to be the same as the users of the financial statements because such users may be expected to read the other information to provide context to the financial statements.
- Judgments about materiality take into account the specific circumstances of the misstatement, considering whether users would be influenced by the effect of the uncorrected misstatement. Not all misstatements will influence the economic decisions of users.

- Judgments about materiality involve both qualitative and quantitative considerations. Accordingly, such judgments may take into account the nature or magnitude of the items that the other information addresses in the context of the entity's annual report.

Other Information (Ref: par. .12)

.A13 The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive:

- Management report, management commentary, or operating and financial review or similar reports by those charged with governance (for example, a directors' report)
- Chairman's statement
- Corporate governance statement
- Management's internal control and risk assessment reports
- Financial summaries or highlights
- Employment data
- Planned capital expenditures
- Financial ratios
- Names of officers and directors
- Selected quarterly data

Obtaining the Other Information (Ref: par. .13–.14)

.A14 Determining the document or documents that comprise the annual report is often clear based on law, regulation, or custom. In many cases, management or those charged with governance may have customarily issued a package of documents that, together, comprise the annual report or may have committed to do so. In some cases, it may not be clear which documents comprise the annual report. In such cases, the timing and purpose of the documents (and for whom they are intended) are matters that may be relevant to the auditor's determination of which documents are the annual report.

.A15 In accordance with paragraph .13*a*, management's written acknowledgment may be included in the engagement letter, an amendment to the engagement letter, a representation letter, or some other written communication.

.A16 Management, or those charged with governance, is responsible for preparing the annual report. The auditor may communicate the following to management or those charged with governance:

- The auditor's expectations in relation to obtaining the final version of the annual report (including a combination of documents that, together, comprise the annual report) in a timely manner prior to the date of the auditor's report such that the auditor can complete the procedures required by this section before the date of the auditor's report, or if that is not possible, as soon as practicable and, in any case, prior to the entity's issuance of such information

- The possible implications when the other information is obtained after the date of the auditor's report

.A17 The communications referred to in paragraph .A16 may be particularly appropriate in the following instances:

- In an initial audit engagement
- When there has been a change in management or those charged with governance
- When other information is expected to be obtained after the date of the auditor's report

.A18 When those charged with governance are to approve the other information prior to its issuance by the entity, the final version of such other information is the version that has been approved by those charged with governance for issuance.

.A19 In some cases, the entity's annual report may be a single document to be released, in accordance with law or regulation or the entity's reporting practice, shortly after the entity's financial reporting period such that it is available to the auditor prior to the date of the auditor's report. In other cases, such a document may not be required to be released until a later time, or at a time of the entity's choosing. There may also be circumstances in which the entity's annual report is a combination of documents, each subject to different requirements or reporting practices by the entity with respect to the timing of their release.

.A20 Obtaining the other information in a timely manner prior to the date of the auditor's report enables any revisions that are found to be necessary to the financial statements, the auditor's report, or the other information prior to their issuance. The audit engagement letter[5] may make reference to an agreement with management to make available to the auditor the other information in a timely manner, and, if possible, prior to the date of the auditor's report.

.A21 When other information is made available to users only via the entity's website, the version of the other information obtained from the entity, rather than directly from the entity's website, is the relevant document on which the auditor would perform procedures in accordance with this section. The auditor has no responsibility in accordance with this section to search for other information, including other information that may be on the entity's website, nor to perform any procedures to confirm that other information is appropriately displayed on the entity's website or otherwise has been appropriately transmitted or displayed electronically.

.A22 The auditor is not precluded from dating or issuing the auditor's report if the auditor has not obtained some or all of the other information.

[5]Paragraph .A23 of section 210A, *Terms of Engagement*.

.A23 When the other information is obtained after the date of the auditor's report, the auditor is not required to update the procedures performed in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*.[6]

.A24 Section 580, *Written Representations*, establishes requirements and provides guidance on the use of written representations. The written representation regarding other information that will be available only after the date of the auditor's report is intended to support the auditor's ability to complete the procedures required by this section with respect to such information. In addition, the auditor may find it useful to request other written representations, such as the following:

- That management has informed the auditor of all the documents that it expects to issue that may be other information
- That the financial statements and any other information obtained by the auditor prior to the date of the auditor's report are consistent with one another, and the other information does not contain any material misstatements
- With regard to other information that has not been obtained by the auditor prior to the date of the auditor's report, that management intends to prepare and issue such other information and the expected timing of such issuance

.A25 In accordance with paragraph .14, appropriate actions that the auditor may take include the following:

- Obtaining those documents from management and performing the procedures required by this section as soon as practical
- Communicating the matter to those charged with governance, if applicable
- Considering the need to obtain legal advice

Reading and Considering the Other Information (Ref: par. .16–.17)

.A26 Section 200[7] requires the auditor to plan and perform the audit with professional skepticism. Maintaining professional skepticism when reading and considering the other information includes, for example, recognizing that management may be overly optimistic about the success of its plans.

.A27 In accordance with section 220A, *Quality Control for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*,[8] the engagement partner is required to take responsibility for the direction, supervision, and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements. In the context of this section, factors that may be considered when

[6]Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[7]Paragraph .17 of section 200.

[8]Paragraph .17*a* of section 220A, *Quality Control for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*.

determining the appropriate engagement team members to address the requirements of paragraphs .16–.17 of this section include the following:

- The relative experience of engagement team members
- Whether the engagement team members have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge
- The degree of judgment involved in addressing the requirements of paragraphs .16–.17 of this section, for example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component

.A28 Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements. Examples of such amounts or other items may include the following:

- Tables, charts, or graphs containing extracts of the financial statements
- A disclosure providing greater detail about a balance or account shown in the financial statements, such as "Revenue for 20X1 was XXX million from product X and YYY million from product Y"
- Descriptions of the financial results, such as "Total research and development expense was XXX in 20X1"

.A29 In evaluating the consistency of selected amounts or other items in the other information with the financial statements, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements, with such amounts or other items in the financial statements.

.A30 Selecting the amounts or other items to compare is a matter of professional judgment. Factors relevant to this judgment include the following:

- The significance of the amount or other item in the context in which it is presented, which may affect the importance that users would attach to the amount or other item (for example, a key ratio or amount)
- If quantitative, the relative size of the amount compared with accounts or items in the financial statements or the other information to which they relate
- The sensitivity of the particular amount or other item in the other information, for example, share-based payments for senior management

.A31 Determining the nature and extent of procedures to address the requirement in paragraph .16 is a matter of professional judgment, recognizing that the auditor's responsibilities under this section do not constitute an assurance engagement on the other information or impose an obligation to obtain assurance about the other information. Examples of such procedures include the following:

- For information that is intended to be the same as information in the financial statements, comparing the information to the financial statements
- For information intended to convey the same meaning as disclosures in the financial statements, comparing the words used and considering the significance of differences in wording used and whether such differences imply different meanings
- Obtaining a reconciliation between an amount within the other information and the financial statements from management
- Comparing items in the reconciliation to the financial statements and the other information
- Checking whether the calculations within the reconciliation are arithmetically accurate

.A32 Evaluating the consistency of selected amounts or other items in the other information with the financial statements includes, when relevant given the nature of the other information, the manner of their presentation compared to the financial statements.

.A33 Other information may include amounts or items that are related to the auditor's knowledge obtained in the audit (other than those in paragraph .16). Examples of such amounts or items may include the following:

- A disclosure of the units produced or a table summarizing such production by geographical region
- A statement that "the company introduced product X and product Y during the year"
- A summary of the locations of the entity's major operations, such as "the entity's major center of operation is in country X, and there are also operations in countries Y and Z"

.A34 The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control, obtained in accordance with SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.[9]SAS No. 145 sets out the auditor's required understanding, which includes such matters as obtaining an understanding of the following:

a. The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT
b. The relevant industry, regulatory, and other external factors

[9]Paragraphs .12–.13 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.*

c. The relevant measures used, internally and externally, to assess the entity's financial performance

d. The entity's internal control

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A35 The auditor's knowledge obtained in the audit may also include matters that are prospective in nature. Such matters may include, for example, business prospects and future cash flows that the auditor considered when evaluating the assumptions used by management in performing impairment tests on intangible assets such as goodwill, or when evaluating management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

.A36 In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,[10] the group auditor decides to make reference to a component auditor in the auditor's report on the group financial statements, the group auditor's knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

.A37 While remaining alert for indications that a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit, the auditor may focus on those matters in the other information that are of sufficient importance that a misstatement of the other information in relation to those matters could be material.

.A38 In relation to many matters in the other information, the auditor's recollection of the audit evidence obtained and conclusions reached during the audit may be sufficient to enable the auditor to consider whether a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit. For example, the auditor may be able to consider whether a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit in light of the auditor's recollection of discussions held with management or those charged with governance or findings from procedures carried out during the audit, such as the reading of board minutes, without the need to take further action.

.A39 The manner in which an auditor resolves a concern regarding whether other information is materially inconsistent with the auditor's knowledge obtained in the audit, is a matter of professional judgment. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team or relevant component auditors is appropriate as a basis for the auditor's consideration of whether a material misstatement exists. Whether, and if so, the extent to which, the

[10]Paragraph .24 of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

auditor refers to relevant audit documentation or makes inquiries of relevant members of the engagement team or relevant component auditors is a matter of professional judgment.

.A40 It may not be necessary for the auditor to refer to relevant audit documentation or to make inquiries of relevant members of the engagement team or relevant component auditors about any matter included in the other information. This may be the case, for example, when the group auditor decides to make reference to a component auditor in the auditor's report in accordance with section 600A,[11] and the group auditor has obtained sufficient knowledge in connection with the group audit about matters in the other information relating to the significant component with respect to which the component auditor has performed an audit of the financial statements.

.A41 Other information may include discussion of matters that are not related to the financial statements and may also extend beyond the auditor's knowledge obtained in the audit. For example, the other information may include statements about the entity's greenhouse gas emissions.

.A42 Remaining alert for indications that a material misstatement of fact exists or the other information is otherwise misleading could potentially result in the auditor identifying such matters as the following:

- Information that omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information
- Differences between the other information and the general knowledge, apart from the knowledge obtained in the audit, of the engagement team member reading the other information that leads the auditor to believe that the other information appears to be materially misstated
- An internal inconsistency in the other information that leads the auditor to believe that the other information appears to be materially misstated

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated (Ref: par. .19)

.A43 The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management's explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

.A44 Conversely, the discussion with management may provide further information that supports the auditor's conclusion that a material misstatement of the other information exists.

[11]Paragraph .24 of section 600A.

.A45 It may be more difficult for the auditor to challenge management on matters of judgment than on those of a more factual nature. However, there may be circumstances in which the auditor concludes that the other information contains a statement that is not consistent with the financial statements or the auditor's knowledge obtained in the audit. These circumstances may raise doubt about the other information, the financial statements, or the auditor's knowledge obtained in the audit.

.A46 Because there is a wide range of possible material misstatements of the other information, the nature and extent of other procedures the auditor may perform to conclude whether a material misstatement of the other information exists are matters of the auditor's professional judgment in the circumstances.

.A47 When a matter is unrelated to the financial statements or the auditor's knowledge obtained in the audit, the auditor may not be able to fully assess management's responses to the auditor's inquiries. Nevertheless, based on management's further information or explanations, or following changes made by management to the other information, the auditor may be satisfied that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated. When the auditor is unable to conclude that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated, the auditor may request management to consult with a qualified third party (for example, management's expert or legal counsel). In certain cases, after considering the responses from management's consultation, the auditor may not be able to conclude whether a material misstatement of the other information exists. Actions the auditor may then take include one or more of the following:

- Obtaining advice from the auditor's legal counsel
- Considering the implications for the auditor's report, for example, whether to describe the circumstances when there is a limitation imposed by management
- Withdrawing from the audit, when withdrawal is possible under applicable law or regulation

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: par. .21)

.A48 The actions the auditor takes if the other information is not corrected after communicating with those charged with governance are a matter of the auditor's professional judgment. The auditor may consider whether the rationale given by management and those charged with governance for not making the correction raises doubt about the integrity or honesty of management or those charged with governance, such as when the auditor suspects an intention to mislead. The auditor may also consider it appropriate to seek legal advice. In some cases, the auditor may be required by law, regulation, or other professional standards to communicate the matter to a regulator or relevant professional body.

Reporting Implications (Ref: par. .21a)

.A49 In rare circumstances, a disclaimer of opinion on the financial statements may be appropriate when the refusal to correct the material misstatement of the other information casts such doubt on the integrity of management and those charged with governance that it calls into question the reliability of audit evidence in general.

Withdrawal From the Engagement (Ref: par. .21c)

.A50 Withdrawal from the engagement, when withdrawal is possible under applicable law or regulation, may be appropriate when the circumstances surrounding the refusal to correct the material misstatement of the other information cast such doubt on the integrity of management and those charged with governance that it calls into question the reliability of representations obtained from them during the audit.

Considerations Specific to Governmental Entities (Ref: par. .21b–c)

.A51 In audits of governmental entities, withdrawal from the engagement or withholding the auditor's report may not be possible under law or regulation. In such cases, the auditor may issue a report or written communication to those charged with governance and the appropriate statutory body, if applicable, giving details of the material misstatement.

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained After the Date of the Auditor's Report (Ref: par. .22)

.A52 If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, and such a material misstatement has been corrected, the auditor's procedures necessary in the circumstances include determining that the correction has been made (in accordance with paragraph .20*a*) and may include reviewing the steps taken by management to communicate with those in receipt of the other information, if previously issued, to inform them of the revision.

.A53 If those charged with governance do not agree to revise the other information, taking appropriate action to seek to have the uncorrected misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report requires the exercise of professional judgment and may be affected by relevant law or regulation in the jurisdiction. Accordingly, the auditor may consider it appropriate to seek legal advice about the auditor's legal rights and obligations.

.A54 When a material misstatement of the other information remains uncorrected, appropriate actions that the auditor may take to seek to have the uncorrected material misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report, when permitted by law or regulation, include, for example, the following:

- Providing a new or amended auditor's report to management, including a modified section in accordance with paragraph .25, and requesting management to provide this new or amended auditor's report to anyone in receipt of the financial statements and the auditor's report. In doing so, the auditor may need to consider the effect, if any, on the date of the new or amended auditor's report, in view of the requirements of GAAS or applicable law or regulation. The auditor may also review the steps taken by management to provide the new or amended auditor's report to such users.
- Bringing the material misstatement of the other information to the attention of known users of the financial statements and the auditor's report.
- Communicating with a regulator or relevant professional body about the uncorrected material misstatement.
- Considering the implications for engagement continuance (see also paragraph .A51).

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated (Ref: par. .23)

.A55 In reading the other information, the auditor may become aware of new information that has implications for the following:

- The auditor's understanding of the entity and its environment, the financial reporting framework, and the entity's system of internal control, which may indicate the need to revise the auditor's risk assessment[12]
- The auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements[13]
- The auditor's responsibilities relating to subsequent events[14]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Reporting (Ref: par. .24–.25)

.A56 Illustrative examples of the "Other Information" section in the auditor's report are included in the exhibit.

Reporting Implications When the Auditor's Opinion on the Financial Statements Is Qualified or Adverse (Ref: par. .25)

.A57 A qualified or adverse auditor's opinion on the financial statements may not have an impact on the statement required by paragraph .24*f* if the matter with respect to the

[12]Paragraphs .11, .31, and .A1 of SAS No. 145.

[13]Section 450, *Evaluation of Misstatements Identified During the Audit.*

[14]Paragraphs .10 and .14 of section 560.

auditor's opinion has been modified is not included or otherwise addressed in the other information, and the matter does not affect any part of the other information. For example, a qualified opinion on the financial statements because of nondisclosure of directors' remuneration as required by the applicable financial reporting framework may have no implications for the reporting required under this section. In other circumstances, there may be implications for such reporting as described in paragraphs .A58–.A61.

Qualified Opinion Due to a Material Misstatement in the Financial Statements

.A58 In circumstances in which the auditor's opinion is qualified, consideration may be given to whether the other information is also materially misstated for the same matter as, or a matter related to, the matter giving rise to the qualified opinion on the financial statements.

Qualified Opinion Due to Limitation of Scope

.A59 When there is a limitation of scope with respect to a material item in the financial statements, the auditor will not have obtained sufficient appropriate audit evidence about that matter. In these circumstances, the auditor may be unable to conclude whether the amounts or other items in the other information related to this matter result in a material misstatement of the other information. Accordingly, the auditor may need to modify the statement required by paragraph .24*f* to refer to the auditor's inability to consider management's description of the matter in the other information with respect to which the auditor's opinion on the financial statements has been qualified, as explained in the Basis for Qualified Opinion paragraph. The auditor is, nevertheless, required to report any other uncorrected material misstatements of the other information that have been identified.

Adverse Opinion

.A60 An adverse opinion on the financial statements relating to a specific matter or matters described in the Basis for Adverse Opinion paragraph does not justify the omission of reporting of material misstatements of the other information that the auditor has identified in the auditor's report in accordance with paragraph .24*f*. When an adverse opinion has been expressed on the financial statements, the auditor may need to appropriately modify the statement required by paragraph .24*f*, for example, to indicate that amounts or items in the other information are materially misstated for the same matter as, or a related matter to, the matter giving rise to the adverse opinion on the financial statements.

Disclaimer of Opinion

.A61 When the auditor disclaims an opinion on the financial statements, providing further details about the audit, including a section to address other information, may overshadow the disclaimer of opinion on the financial statements as a whole. Accordingly, in those circumstances, as required by section 705,[15] the auditor's report does not include a section addressing the reporting requirements under this section.

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[15] Paragraph .30 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Exhibit — Illustrations of Other Information Sections to Be Included in Auditor's Reports Relating to Other Information Included in the Annual Report

.A62

Illustration 1 — The auditor has not identified an uncorrected material misstatement of the other information.

Illustration 2 — The auditor has concluded that an uncorrected material misstatement of the other information exists.

Illustration 1: The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information

Other Information [Included in the Annual Report]

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*][1] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

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

[1] A more specific description of the other information, such as "the management report and chairman's statement," may be used to identify the other information.

Illustration 2: The Auditor Has Concluded That an Uncorrected Material Misstatement of the Other Information Exists

Other Information [Included in the Annual Report]

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*][2] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report. As described below, we have concluded that such an uncorrected material misstatement of the other information exists.

[*Description of material misstatement of the other information*]

[2]See footnote 1.

AU-C Section 725

Supplementary Information in Relation to the Financial Statements as a Whole

(With SAS No. 118 supersedes SAS No. 29.)

Source: SAS No. 119; SAS No. 122; SAS No. 125; SAS No. 136; SAS No. 137; SAS No. 140.

See section 9725 for interpretations of this section.

Effective for audits of financial statements for periods beginning on or after December 15, 2010, unless otherwise indicated. Early application is permitted.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The information covered by this section is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. This section also may be applied, with the report wording adapted as necessary, when an auditor has been engaged to report on whether required supplementary information[1] is fairly stated, in all material respects, in relation to the financial statements as a whole. When the auditor is performing an audit of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, applies. Accordingly, the requirements in paragraph .09 of this section are replaced by the requirements in section 703, for such audits only. (Ref: par. .A1–.A6) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

.02 This section is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

[1]*Required supplementary information* is defined in paragraph .04 of section 730, *Required Supplementary Information*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Objective

.03 The objective of the auditor, when engaged to report on supplementary information in relation to the financial statements as a whole, is to

a. evaluate the presentation of the supplementary information in relation to the financial statements as a whole and

b. report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Definition

.04 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements. (Ref: par. .A7–.A8)

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Requirements

Procedures to Determine Whether Supplementary Information Is Fairly Stated, in All Material Respects, in Relation to the Financial Statements as a Whole (Ref: par. .A9–.A15)

.05 In order to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should determine that all of the following conditions are met:

a. The supplementary information was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements.

b. The supplementary information relates to the same period as the financial statements.

c. The auditor issued an audit report on the financial statements that contained neither an adverse opinion nor a disclaimer of opinion. (Paragraph .11 addresses reporting while not opining on supplementary information when the report on the financial statements contains an adverse opinion or a disclaimer of opinion.)

d. The supplementary information will accompany the entity's audited financial statements, or such audited financial statements will be made readily available by the entity. (Ref: par. .A9)

[Revised, April 2012 and January 2013, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.06 The auditor should obtain the agreement of management that it acknowledges and understands its responsibility

a. for the preparation of the supplementary information in accordance with the applicable criteria.

b. to provide the auditor with the written representations described in paragraph .07*g*.

c. to include the auditor's report on the supplementary information in any document that contains the supplementary information and that indicates that the auditor has reported on such supplementary information.

d. to present the supplementary information with the audited financial statements or, if the supplementary information will not be presented with the audited financial statements, to make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance by the entity of the supplementary information and the auditor's report thereon. (Ref: par. .A9)

.07 In addition to the procedures performed during the audit of the financial statements, in order to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should perform the following procedures using the same materiality level used in the audit of the financial statements:

a. Inquire of management about the purpose of the supplementary information and the criteria used by management to prepare the supplementary information, such as an applicable financial reporting framework, criteria established by a regulator, a contractual agreement, or other requirements

b. Determine whether the form and content of the supplementary information complies with the applicable criteria

c. Obtain an understanding about the methods of preparing the supplementary information and determine whether the methods of preparing the supplementary information have changed from those used in the prior period and, if the methods have changed, the reasons for such changes

d. Compare and reconcile the supplementary information to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves

e. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information

f. Evaluate the appropriateness and completeness of the supplementary information, considering the results of the procedures performed and other knowledge obtained during the audit of the financial statements (Ref: par. .A13)

g. Obtain written representations from management

   i. that it acknowledges its responsibility for the presentation of the supplementary information in accordance with the applicable criteria;

   ii. that it believes the supplementary information, including its form and content, is fairly presented in accordance with the applicable criteria;

   iii. that the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement or presentation have changed, the reasons for such changes;

   iv. about any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information; and

   v. that when the supplementary information is not presented with the audited financial statements, management will make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance by the entity of the supplementary information and the auditor's report thereon. (Ref: par. .A9)

.08 The auditor has no responsibility for the consideration of subsequent events with respect to the supplementary information. However, if information comes to the auditor's attention

a. prior to the release of the auditor's report on the financial statements regarding subsequent events that affect the financial statements, or

b. subsequent to the release of the auditor's report on the financial statements regarding facts that, had they been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report,

the auditor should apply the relevant requirements in section 560, *Subsequent Events and Subsequently Discovered Facts*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Reporting

.09 When the entity presents the supplementary information with the financial statements, the auditor should report on the supplementary information in either (*a*) a separate section in the auditor's report on the financial statements with the heading "Supplementary Information," or other appropriate heading, or (*b*) in a separate report on the supplementary information.[2] The supplementary information section in the auditor's report on the financial statements or separate report should include the following elements:

a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole

b. A statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements

c. A statement that the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements

d. A statement that the supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America

e. If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole

f. If the auditor issues a qualified opinion on the financial statements and the qualification has an effect on the supplementary information, a statement that, in the auditor's opinion, except for the effects on the supplementary information of (refer to the paragraph in the auditor's report explaining the qualification), such information is fairly stated, in all material respects, in relation to the financial statements as a whole

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.10 When the audited financial statements are not presented with the supplementary information, the auditor should report on the supplementary information in a separate report. When reporting separately on the supplementary information, the report should include, in addition to the elements in paragraph .09, a reference to the report on the financial statements, the date of that report, the nature of the opinion expressed on the financial statements, and any report modifications. (Ref: par. .A16)

.11 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion and the auditor has been engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to such financial statements as a whole, the auditor is precluded from expressing an opinion on the supplementary information. When permitted by law or regulation, the auditor may

[2][Footnote deleted by the issuance of SAS No. 140, April 2020.]

withdraw from the engagement to report on the supplementary information. If the auditor does not withdraw, the auditor's report on the supplementary information should state that because of the significance of the matter disclosed in the auditor's report, it is inappropriate to, and the auditor does not, express an opinion on the supplementary information.

.12 The date of the auditor's report on the supplementary information in relation to the financial statements as a whole should not be earlier than the date on which the auditor completed the procedures required in paragraph .07.

.13 If the auditor concludes, on the basis of the procedures performed, that the supplementary information is materially misstated in relation to the financial statements as a whole, the auditor should discuss the matter with management and propose appropriate revision of the supplementary information. If management does not revise the supplementary information, the auditor should either

a. modify the auditor's opinion on the supplementary information and describe the misstatement in the auditor's report or

b. f a separate report is being issued on the supplementary information, withhold the auditor's report on the supplementary information.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibility for information that a designated accounting standard setter[3] requires to accompany an entity's basic financial statements is addressed in section 730, *Required Supplementary Information*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A2 The auditor's responsibility relating to other information whether financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report, excluding required supplementary information, is addressed in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.A3 The supplementary information need not be presented with the audited financial statements in order for the auditor to express an opinion on whether such supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. However, in accordance with paragraph .10, if the supplementary information is not presented with the audited financial statements, the auditor's report on the supplementary information is required to make reference to the auditor's report on the financial statements.

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[3]*Designated accounting standards setter* is defined in paragraph .04 of section 730. [Footnote renumbered and revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A4 The auditor may be engaged to audit a specified element, account, or item of a financial statement for the purpose of a separate presentation, in accordance with section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. In such an engagement, the auditor's procedures are designed to provide the auditor with reasonable assurance that the supplementary information is not misstated by an amount that would be material to the information itself. An engagement to examine the supplementary information or an assertion related to the supplementary information also may be performed in accordance with AT-C section 205, *Examination Engagements*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A5 Although an auditor has no obligation to apply auditing procedures to supplementary information presented outside the basic financial statements, the auditor may choose to modify or redirect certain of the procedures to be applied in the audit of the basic financial statements so that the auditor may express an opinion on the supplementary information in relation to the financial statements as a whole.

.A6 Management may include nonaccounting information and accounting information that is not directly related to the basic financial statements in a document containing the basic financial statements. Ordinarily, such information would not have been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, the auditor would be unable to opine on the information in relation to the financial statements as a whole. In some circumstances, however, such information may have been obtained or derived from accounting records that have been tested by the auditor (for example, number of units produced related to royalties under a license agreement or number of employees related to a given payroll period). Accordingly, the auditor may be in a position to express an opinion on such information in relation to the financial statements as a whole.

Definition (Ref: par. .04)

.A7 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity.

.A8 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements.

Procedures to Determine Whether Supplementary Information Is Fairly Stated, in All Material Respects, in Relation to the Financial Statements as a Whole (Ref: par. .05–.08)

The Meaning of Readily Available (Ref: par. .05e, .06d, and .07f)

.A9 Audited financial statements are deemed to be readily available if a third party user can obtain the audited financial statements without any further action by the entity. For example, financial statements on an entity's website may be considered readily available, but being available upon request is not considered readily available.

Procedures Performed on Supplementary Information (Ref: par. .07)

.A10 When engaged to report on supplementary information in relation to the financial statements as a whole, the auditor need not apply procedures as extensive as would be necessary to express an opinion on the information on a stand-alone basis.

.A11 With respect to the supplementary information, the auditor is not required to obtain a separate understanding of the entity's internal control or to assess fraud risk.

.A12 The auditor may consider materiality in determining which information to compare and reconcile to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves.

.A13 In evaluating the appropriateness and completeness of the supplementary information as required by paragraph 07*f*, the auditor may consider testing accounting or other records through observation or examination of source documents or other procedures ordinarily performed in an audit of the financial statements.

.A14 The auditor may consider whether it is appropriate to address the supplementary information in procedures that the auditor performs in auditing the financial statements, including, but not limited to, the following:

a. Obtaining an updated representation letter, in accordance with section 580, *Written Representations*[4]

b. Performing subsequent events procedures, in accordance with section 560

c. Sending a letter of audit inquiry to the client's lawyer specifically regarding the information contained in the supplementary information, in accordance with section 501, *Audit Evidence—Specific Considerations for Selected Items*[5]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

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[4]Paragraph .A24 of section 580, *Written Representations*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[5]Paragraphs .18–.24 of section 501, *Audit Evidence—Specific Considerations for Selected Items*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Considerations Specific to Audits of Governmental Entities

.A15 For most state and local governments, the auditor's report on the financial statements includes multiple opinions to address individual reporting units or aggregation of reporting units of the governmental entity. Accordingly, materiality is considered by the auditor for each opinion unit. However, in the context of this section, the auditor's opinion on the supplementary information is in relation to the financial statements as a whole. Accordingly, in this situation, materiality is considered at a level that represents the entire governmental entity.

Reporting (Ref: par. .09–.13)

.A16 When reporting on supplementary information in a separate report, the auditor may consider including an alert that restricts the use of the separate report solely to the appropriate specified parties, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, to avoid potential misinterpretation or misunderstanding of the supplementary information that is not presented with the financial statements. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Exhibit — Illustrative Reporting Examples When the Auditor Is Reporting on Supplementary Information in Relation to the Financial Statements as a Whole

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Illustration 1 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Illustration 2 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Illustration 3 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Disclaiming an Opinion on the Financial Statements

Illustration 4 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Illustration 5 — A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Illustration 6 — A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Illustration 7 — A Separate Report When the Auditor Is Disclaiming an Opinion on the Financial Statements

Illustration 8 — A Separate Report When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Illustration 1 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 2 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effect on the supplementary information of [*describe reason for qualification of the auditor's opinion on the financial statements and reference the other-matter paragraph*], the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 3 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Disclaiming an Opinion on the Financial Statements

We were engaged for the purpose of forming an opinion on the basic financial statements as a whole. The [*identify accompanying supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Because of the significance of the matter described above [*the auditor may describe the basis for the disclaimer of opinion*], it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 4 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Because of the significance of the matter described above [*the auditor may describe the basis for the adverse opinion*], it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 5 — A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements*] which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The [*identify supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 6 — A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements, the nature of the opinion expressed on the financial statements, and a description of the report modifications*]. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The [*identify supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effect on the accompanying information of the qualified opinion on the financial statements as described above, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 7 — A Separate Report When the Auditor Is Disclaiming an Opinion on the Financial Statements

We were engaged to audit the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements*]. However, the scope of our audit of the financial statements was not sufficient to enable us to express an opinion because [*describe reasons*] and accordingly we did not express an opinion on such financial statements. The [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Because of the significance of the matter discussed above, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 8 — A Separate Report When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements*] which stated that the financial statements are not presented fairly in accordance with [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America [GAAP])*] because [*describe reasons*]. The [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Because of the significance of the matter discussed above, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 9725

Supplementary Information in Relation to the Financial Statements as a Whole: Auditing Interpretations of Section 725

1. Dating the Auditor's Report on Supplementary Information

.01 *Question*—In accordance with section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, the auditor's report on supplementary information should not be dated earlier than the date on which the auditor completed the procedures required by section 725.[1] When the auditor completes those procedures subsequent to the date of the auditor's report on the audited financial statements, the auditor is not required to obtain additional evidence with respect to the audited financial statements. When reporting on the supplementary information (either in a separate report or in a separate section within the auditor's report on the financial statements) after the date of the auditor's report on the financial statements, how may an auditor make it clear that no additional procedures were performed on the audited financial statements subsequent to the date of the auditor's report on those financial statements?

.02 *Interpretation*—Although not required, an auditor may

a. when issuing a separate report on the supplementary information, include in such report a statement that the auditor has not performed any auditing procedures with respect to the audited financial statements subsequent to the date of the auditor's report on those audited financial statements (see paragraph .03 of this interpretation), or

b. when reissuing a report on the audited financial statements to include a separate section to report on the supplementary information, include two report dates to indicate that the date of reporting on the supplementary information is as of the later date (see paragraph .04 of this interpretation).

.03 The following illustrative separate report on supplementary information includes additional language intended to make it clear that no procedures were performed subsequent to the date of the auditor's report on the audited financial statements.

[1]Paragraph .12 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.

<u>Independent Auditor's Report on [*Identify Supplementary Information*]</u>

[*Appropriate Addressee*]

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements, for example, "September 15, 20X1"*] which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. *We have not performed any procedures with respect to the audited financial statements subsequent to* [*date of the auditor's report on the financial statements, for example, "September 15, 20X1"*].

The [*identify supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[*Auditor's signature*]

[*Auditor's city and state*]

December 1, 20X1 [*Date of the auditor's report on the supplementary information—not to be earlier than the date on which the auditor completed the procedures required by section 725*][2]

.04 The following illustrative report on the audited financial statements includes a separate section to report on supplementary information subsequent to the date of the report on the audited financial statements. For this illustration, March 31, 20X2, is the original date of the report on the audited financial statements.

[2]Paragraph .07 of section 725.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing these financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than

for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[3]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on [*Identify Supplementary Information*]

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the

[3]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[*Auditor's signature*]

[*Auditor's city and state*]

March 31, 20X2, except for our report on the supplementary information for which the date is June 1, 20X2 [Date of the auditor's report on the audited financial statements, with a later date used for the paragraph labeled "Report on [*identify supplementary information*]," which is as of a date not earlier than the date on which the auditor completed the procedures required by paragraph .07 of section 725.

[Issue Date: July 2011; Revised: October 2011.]

AU-C Section 730

Required Supplementary Information

(Supersedes SAS No. 52 section 558.)

Source: SAS No. 120; SAS No. 122; SAS No. 137; SAS No. 140.

Effective for audits of financial statements for periods beginning on or after December 15, 2010, unless otherwise indicated. Early application is permitted.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility with respect to information that a designated accounting standards setter requires to accompany an entity's basic financial statements (hereinafter referred to as *required supplementary information*). In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover required supplementary information. (Ref: par. .A1) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Effective Date

.02 This section is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

Objective

.03 The objectives of the auditor when a designated accounting standards setter requires information to accompany an entity's basic financial statements are to perform specified procedures in order to

a. describe, in the auditor's report, whether required supplementary information is presented and

b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standards setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standards setter.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Basic financial statements. Financial statements presented in accordance with an applicable financial reporting framework as established by a designated accounting standards setter, excluding required supplementary information.

Designated accounting standards setter. A body designated by the Council of the AICPA to promulgate GAAP pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Prescribed guidelines. The authoritative guidelines established by the designated accounting standards setter for the methods of measurement and presentation of the required supplementary information.

Required supplementary information. Information that a designated accounting standards setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Procedures

.05 The auditor should apply the following procedures to required supplementary information:

a. Inquire of management about the methods of preparing the information, including (i) whether it has been measured and presented in accordance with prescribed guidelines, (ii) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and (iii) whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information

b. Compare the information for consistency with (i) management's responses to the foregoing inquiries, (ii) the basic financial statements, and (iii) other knowledge obtained during the audit of the basic financial statements

c. Obtain written representations from management (i) that it acknowledges its responsibility for the required supplementary information; (ii) about whether the required supplementary information is measured and presented in accordance with prescribed guidelines; (iii) about whether the methods of measurement or presentation have changed from those used in the prior period and, if so, the reasons for such changes; and (iv) about any significant assumptions or interpretations underlying the measurement or presentation of the required supplementary information[1]

.06 If the auditor is unable to complete the procedures in paragraph .05, the auditor should consider whether management contributed to the auditor's inability to complete the procedures. If the auditor concludes that the inability to complete the procedures was due to significant difficulties encountered in dealing with management, the auditor should inform those charged with governance.[2]

Reporting

.07 The auditor should include a separate section in the auditor's report on the financial statements with the heading "Required Supplementary Information," or other appropriate heading.[3] The required supplementary information section in the auditor's report on the financial statements should include language to explain the following circumstances, as applicable:

a. The required supplementary information is included, and the auditor has applied the procedures in paragraph .05 of this section.

b. The required supplementary information is omitted.

c. Some required supplementary information is missing and some is presented in accordance with the prescribed guidelines.

d. The auditor has identified material departures from the prescribed guidelines.

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[1]See section 580, *Written Representations*, for additional requirements and guidance with respect to obtaining written representations from management as part of an audit of financial statements performed in accordance with generally accepted auditing standards. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[2]See paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*, for additional guidance when the auditor encounters significant difficulties in dealing with management during the audit. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[3][Footnote deleted by the issuance of SAS No. 140, April 2020.]

e. The auditor is unable to complete the procedures in paragraph .05 of this section.

f. The auditor has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.08 If the entity has presented all or some of the required supplementary information, the required supplementary information section in the auditor's report on the financial statements referred to in paragraph .07 should include the following elements: (Ref: par. .A2)

a. A statement that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the required supplementary information*] be presented to supplement the basic financial statements

b. A statement that such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

c. If the auditor is able to complete the procedures in paragraph .05,

   i. a statement that the auditor has applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to the auditor's inquiries, the basic financial statements, and other knowledge the auditor obtained during the audit of the basic financial statements

   ii. a statement that the auditor does not express an opinion or provide any assurance on the information because the limited procedures do not provide the auditor with sufficient evidence to express an opinion or provide any assurance

d. If the auditor is unable to complete the procedures in paragraph .05,

   i. a statement that the auditor was unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because [*state the reasons*]

   ii. a statement that the auditor does not express an opinion or provide any assurance on the information

e. If some of the required supplementary information is omitted,

i. a statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements

ii. a statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

iii. a statement that the auditor's opinion on the basic financial statements is not affected by the missing information

f. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that although the auditor's opinion on the basic financial statements is not affected, material departures from prescribed guidelines exist [*describe the material departures from the applicable financial reporting framework*]

g. If the auditor has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that although the auditor's opinion on the basic financial statements is not affected, the results of the limited procedures have raised doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by [*identify designated accounting standards setter*]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.09 If all of the required supplementary information is omitted, the required supplementary information section in the auditor's report on the financial statements should include the following elements:

a. A statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements

b. A statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

c. A statement that the auditor's opinion on the basic financial statements is not affected by the missing information

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibility relating to other information whether financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report, excluding required supplementary information, is addressed in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Reporting (Ref: par. .07–.09)

.A2 Because the required supplementary information accompanies the basic financial statements, the auditor's report on the financial statements includes a discussion of the responsibility taken by the auditor on that information. However, because the required supplementary information is not part of the basic financial statements, the auditor's opinion on the fairness of presentation of such financial statements in accordance with the applicable financial reporting framework is not affected by the presentation by the entity of the required supplementary information or the failure to present some or all of such required supplementary information. Furthermore, if the required supplementary information is omitted by the entity, the auditor does not have a responsibility to present that information.

Exhibit — Examples of Required Supplementary Information Sections in the Auditor's Report on the Financial Statements

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Illustration 1 — The Required Supplementary Information Is Included, the Auditor Has Applied the Specified Procedures, and No Material Departures From Prescribed Guidelines Have Been Identified

Illustration 2 — All Required Supplementary Information Omitted

Illustration 3 — Some Required Supplementary Information Is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines

Illustration 4 — Material Departures From Prescribed Guidelines Identified

Illustration 5 — Specified Procedures Not Completed

Illustration 6 — Unresolved Doubts About Whether the Required Supplementary Information Is in Accordance With Prescribed Guidelines

Illustration 1 — The Required Supplementary Information Is Included, the Auditor Has Applied the Specified Procedures, and No Material Departures From Prescribed Guidelines Have Been Identified

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the required supplementary information*] on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Illustration 2 — All Required Supplementary Information Omitted

Management has omitted [*describe the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Illustration 3 — Some Required Supplementary Information Is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that [*identify the included supplementary information*] be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

Management has omitted [*describe the missing required supplementary information*] that [*identify the applicable financial reporting framework*] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Illustration 4 — Material Departures From Prescribed Guidelines Identified

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the supplementary information*] on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. Although our opinion on the basic financial statements is not affected, the following material departures from the prescribed guidelines exist [*identify the required supplementary information and describe the material departures from the prescribed guidelines*]. We do not express an opinion or provide any assurance on the information.

Illustration 5 — Specified Procedures Not Completed

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the supplementary information*] on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because [*state the reasons*]. We do not express an opinion or provide any assurance on the information.

Illustration 6 — Unresolved Doubts About Whether the Required Supplementary Information Is in Accordance With Prescribed Guidelines

[*Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the supplementary information*] on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. Although our opinion on the basic financial statements is not affected, the results of the limited procedures have raised doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by [*identify designated accounting standards setter*]. [*The auditor may consider including in the report the reason(s) he or she was unable to resolve his or her doubts.*]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Sections 800–899

SPECIAL CONSIDERATIONS

AU-C Section 800

Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks

Source: SAS No. 122; SAS No. 125; SAS No. 127; SAS No. 132; SAS No. 139.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 AU-C sections 200–700 apply to an audit of financial statements. This section addresses special considerations in the application of those AU-C sections to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, a tax, a regulatory, a contractual, or an other basis of accounting. This section does not purport to address all special considerations that may be relevant in the circumstances. (Ref: par. .A1–.A5) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.02 This section is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework. Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

.03 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, applies to audits of special purpose financial statements, as discussed in paragraph .14 of this section. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.04 Section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, addresses the auditor's responsibility and the form and content of the report when the auditor is requested to report on the entity's compliance with aspects of contractual agreements or regulatory requirements in connection with the audit of financial statements.

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.06 The objective of the auditor, when applying generally accepted auditing standards (GAAS) in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to

a. the acceptance of the engagement,

b. the planning and performance of that engagement, and

c. forming an opinion and reporting on the financial statements.

Definitions

.07 For purposes of GAAS, the following terms have the meanings attributed as follows:

Special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

Special purpose framework. A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting: (Ref: par. .A6)

a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).

b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.

c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).

d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.

e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.08 Reference to *financial statements* in this section means "a complete set of special purpose financial statements."[1] The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.09 Reference to *GAAP* in GAAS means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA (Council) pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Requirements

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework (Ref: par. .A7–.A10)

.10 Section 210A, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.[2] In an audit of special purpose financial statements, the auditor should obtain an understanding of

a. the purpose for which the financial statements are prepared,

b. the intended users, and

c. the steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

Preconditions for an Audit (Ref: par. .A11)

.11 Section 210A requires the auditor to establish whether the preconditions for an audit are present, including determining whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable.[3] In an audit of special purpose

[1]Paragraphs .14 and .A9 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .06*a* of section 210A, *Terms of Engagement*.

financial statements, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including

a. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.

b. informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

c. a description of any significant interpretations of the contract on which the special purpose financial statements are based, in the case of special purpose financial statements prepared in accordance with a contractual basis of accounting.

d. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation. (Ref: par. .A12)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Considerations When Planning and Performing the Audit (Ref: par. .A13–.A17)

.12 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AU-C sections relevant to the audit.[4] In planning and performing an audit of special purpose financial statements, the auditor should adapt and apply all AU-C sections relevant to the audit as necessary in the circumstances of the engagement.

.13 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.[5] In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the information presented in the financial statements.

[3] Paragraph .06 of section 210A.

[4] Paragraph .20 of section 200.

[5] Paragraph .12*c* of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Auditor's Responsibilities Regarding the Entity's Ability to Continue as a Going Concern

.14 Irrespective of whether the going concern basis of accounting is relevant to the preparation of the special purpose financial statements, the requirements of section 570 apply regarding the auditor's responsibilities to perform the following tasks: (Ref: par. .A18)

a. Based on the audit evidence obtained, conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

b. When such substantial doubt exists, evaluate the adequacy of the financial statement disclosures.[6]

[Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Forming an Opinion and Reporting Considerations

.15 When forming an opinion and reporting on special purpose financial statements, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. When, in forming an opinion, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary, the auditor should apply the requirements in section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A19–.A22) [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Description of the Applicable Financial Reporting Framework (Ref: par. .A23–.A24)

.16 Section 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.[7] In an audit of special purpose financial statements, the auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

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[6] Paragraphs .20–.22 and .A46 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139]

[7] Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139]

.17 In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should also evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Fair Presentation (Ref: par. .A25–.A29)

.18 Section 700 requires the auditor to evaluate whether the financial statements achieve fair presentation.[8] In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether

a. the financial statements include informative disclosures similar to those required by GAAP, and

b. additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Auditor's Report

.19 Section 700 addresses the form and content of the auditor's report, including the specific ordering for certain elements. In the case of an auditor's report on special purpose financial statements

a. the auditor's report should describe the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains that information, when the financial statements are prepared in accordance with

   i. a regulatory or contractual basis of accounting or

   ii. an other basis of accounting, and the auditor is required to restrict use of the auditor's report pursuant to paragraph .06*a–b* of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. (Ref: par. .A30)

b. if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its

[8] Paragraph .16 or section 700. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .A31)

.20 Except for the circumstances described in paragraph .22, the auditor's report on special purpose financial statements should include an *emphasis-of-matter* paragraph,[9] under an appropriate heading, that includes the following:

a. A statement that the financial statements are prepared in accordance with a special purpose framework

b. A reference to the note to the financial statements that describes that framework

c. A statement that the special purpose framework is a basis of accounting other than GAAP.

d. When a description of the purpose for which the financial statements are prepared or a reference to a note in the special purpose financial statements that contains that information is required pursuant to paragraph .19*a*, a statement that, as a result, the financial statements may not be suitable for another purpose.[10]

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Restricting the Use of the Auditor's Report in an Other-Matter Paragraph (Ref: par. .A32–.A33)

.21 Except for the circumstances described in paragraph .22, the auditor's report on special purpose financial statements should include an *other-matter* paragraph,[11] under an appropriate heading, that restricts[12] the use of the auditor's report when the special purpose financial statements are prepared in accordance with

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[9]Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report.*

[10]Paragraph .06 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[11]Paragraph .07 of section 706. [Footnote renumbered by the issuance of SAS No. 139, March 2020.].

[12]See paragraphs .06*a*–*b* and .07 of section 905. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012,

a. a contractual basis of accounting,

b. a regulatory basis of accounting, or

c. an other basis of accounting when required pursuant to paragraph .06*a–b* of section 905.

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

*Regulatory Basis Financial Statements Intended for General Use (Ref: **par. .A34**)*

.22 If the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the special purpose financial statements together with the auditor's report are intended for general use, the auditor should not include the *emphasis-of-matter* or *other-matter* paragraphs required by paragraphs .20–.21. Instead, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP. The auditor should also, in a separate paragraph, express an opinion about whether the financial statements are prepared in accordance with the special purpose framework. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

*Auditor's Report Prescribed by Law or Regulation (Ref: **par. .A35–.A38**)*

.23 If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, the auditor's report should refer to GAAS only if the auditor's report includes, at a minimum, each of the following elements:

a. A title that clearly indicates that it is the report of an independent auditor

b. An addressee

c. An opinion section that

    i. identifies the special purpose financial statements that have been audited and

    ii. contains an expression of opinion on the special purpose financial statements and a reference to the special purpose framework used to prepare the financial statements and, if applicable, an opinion on whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP when required by paragraph .22

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by SAS No. 125. Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

d. A description of the purpose for which the financial statements are prepared when required by paragraph .19*a*

e. A statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit

f. When applicable, a section that addresses the reporting requirements in paragraphs .24–.27 of section 570

g. A description of management's responsibilities for the preparation and fair presentation of the special purpose financial statements that addresses, and is consistent with, the requirements in paragraphs .31–.33 of section 700

h. A reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when required by paragraph .19*b*

i. If applicable, a reference to the law or regulation and a description of the auditor's responsibilities for an audit of financial statements that addresses, and is consistent with, the requirements in paragraphs .35–.37 of section 700

j. When applicable, a section that addresses the reporting requirements in paragraph .24 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

k. An emphasis-of-matter paragraph that

    i. when required by paragraph .20

        1. indicates that the financial statements are prepared in accordance with a special purpose framework

        2. refers to the note to the financial statements that describes that framework

        3. states that the special purpose framework is a basis of accounting other than GAAP, and

    ii. when required by paragraph .20*d*

        1. describes the purpose for which the financial statements are prepared or refers to a note in the special purpose financial statements that contains that information, and

        2. states that, as a result, the financial statements may not be suitable for another purpose[13]

l. An *other-matter* paragraph that restricts the use of the auditor's report when required by paragraph .21

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[13]Paragraph .06 of section 905.

m. The signature of the auditor's firm

n. The city and state where the auditor's report is issued

o. The date of the auditor's report

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.24 If the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor should reword the prescribed form of report or attach an appropriately worded separate report. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Application and Other Explanatory Material

Introduction

Scope of This Section (Ref: par. .01)

.A1 Special purpose financial statements may be prepared for use by regulatory bodies, the parties to a contract or agreement, or other specified parties. For example, a loan agreement may require the borrower to prepare consolidated financial statements for the lender presented on a contractual basis of accounting, which is not in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) or International Financial Reporting Standards promulgated by the International Accounting Standards Board.

.A2 There may be circumstances in which a regulatory or contractual basis of accounting is based on a general purpose framework, such as U.S. GAAP, established by an authorized or recognized standard-setting organization or by law or regulation, but does not comply with all the requirements of that framework.[14] An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of U.S. GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, section 705 applies. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A3 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special

[14] The term *general purpose framework* is defined in paragraph .10 of section 700. [Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

purpose framework includes all requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A2, the description of the applicable financial reporting framework would refer to the financial reporting provisions of the contract, rather than make reference to U.S. GAAP. The requirements in paragraphs .20–.22 are designed to avoid misunderstandings about compliance with the general purpose framework. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A4 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of GAAS. The requirement in paragraph .20 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A5 Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*, addresses circumstances in which an auditor practicing in the United States is engaged to report on financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to promulgate generally accepted accounting principles (GAAP) when such audited financial statements are intended for use outside the United States. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Definitions

Special Purpose Financial Statements and Special Purpose Frameworks (Ref: par. .07)

.A6 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on a framework promulgated by an authorized or recognized standard-setting organization (for example, FASB or GASB), but does not include all of the requirements of that framework. Such frameworks are regulatory bases of accounting, as described in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework (Ref: par. .10)

.A7 In the case of special purpose financial statements, the financial information needs of the intended users are a factor in determining the acceptability of the financial reporting framework applied in the preparation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A8 The applicable financial reporting framework may encompass the financial reporting standards established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some circumstances, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such an entity. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A9 The acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks. Section 210A discusses the attributes of acceptable financial reporting frameworks, which provide management with an appropriate basis for preparing the financial statements and the auditor with suitable criteria for auditing the financial statements.[15] In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of establishing the value of net assets of an entity at the date of its sale, the seller and purchaser may have agreed that conservative estimates of allowances for uncollectible accounts receivable are appropriate for their needs, even though such financial information may be biased when compared with financial information prepared in accordance with a general purpose framework. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A10 In the case of financial statements prepared in accordance with a contractual basis of accounting, the parties to the contract or agreement may need to agree on the significant interpretations of the contract on which the special purpose financial statements are based. If agreement cannot be reached, the auditor may determine that the framework is not acceptable. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

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[15] Paragraphs .A2–.A3 of section 210A, *Terms of Engagement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Preconditions for an Audit (Ref: par. .11)

.A11 Section 210A also requires the agreed-upon terms of the audit engagement to include references to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.[16]The auditor may discuss with management and, when appropriate, those charged with governance how an auditor's report on financial statements prepared in accordance with a special purpose framework differs from an auditor's report on financial statements prepared in accordance with a general purpose framework. Discussing the expected form and content of the auditor's report may assist management in understanding its responsibilities related to the audit engagement. [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Achieving Fair Presentation (Ref: par. .11d)

.A12 In accordance with section 700, the auditor's evaluation about whether the financial statements achieve fair presentation in accordance with the applicable financial reporting framework requires consideration of the following:[17]

a. The overall presentation, structure and content of the financial statements

b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Also see paragraphs .A25–.A29 of this section. [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Considerations When Planning and Performing the Audit (Ref: par. .12–.13)

.A13 Section 200 requires the auditor to comply with (*a*) relevant ethical requirements relating to financial statement audit engagements and (*b*) all AU-C sections relevant to the audit. It also requires the auditor to comply with each requirement of an AU-C section unless, in the circumstances of the audit, the entire AU-C section is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement in an AU-C section by performing alternative audit procedures to achieve the intent of that requirement.[18] [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A14 An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist.[19]In an audit of special purpose financial

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[16]Paragraph .10*f* of section 210A.

[17]Paragraph .14 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[18]Paragraphs .16, .20, and .24–.26 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

statements, some of the requirements within the relevant AU-C sections may need to be adapted by the auditor. For example, in section 320, *Materiality in Planning and Performing an Audit*, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.[20] In an audit of special purpose financial statements, those judgments may be based on a consideration of the financial information needs of the intended users. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

[.A15] [Paragraph renumbered and deleted by the issuance of SAS No. 139, March 2020.][21]

.A16 In the case of special purpose financial statements, such as those prepared in accordance with a contractual basis of accounting, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with section 320 for purposes of planning and performing the audit of the special purpose financial statements. With respect to interpretations of the contract on which the special purpose financial statements are based, the auditor may determine that an interpretation is significant based on qualitative considerations. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A17 Communication with those charged with governance in accordance with GAAS is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility; for example, when the financial information is prepared solely for management's use. In such cases, the requirements of section 260, *The Auditor's Communication With Those Charged With Governance*, may not be relevant to the audit of the special purpose financial statements, except when the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed to communicate with those charged with governance of the entity relevant matters identified during the audit of the special purpose financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

[19]Paragraph .20 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

[20]Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

[21][Footnote renumbered and deleted by the issuance of SAS No. 139, March 2020.]

Auditor's Responsibilities Regarding the Entity's Ability to Continue as a Going Concern (Ref: par. .14)

Relevance of Going Concern Basis of Accounting to a Special Purpose Framework

.A18 Special purpose financial statements may or may not be prepared in accordance with an applicable financial reporting framework for which the going concern basis of accounting is relevant. The going concern basis of accounting is relevant to a special purpose framework if the special purpose framework requires management, in specified circumstances, to use a basis of accounting other than the going concern basis of accounting. For example, the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities requires management to assess whether the going concern basis of accounting is appropriate, and if not, to use the liquidation basis of accounting. In contrast, the cash or tax bases of accounting do not specify any alternative basis of accounting to be considered and, thus, do not require management to assess whether the going concern basis of accounting is appropriate. Therefore, the going concern basis of accounting is not relevant to special purpose financial statements prepared using those bases of accounting. Depending on the applicable financial reporting framework used in the preparation of the special purpose financial statements, the description in the auditor's report of management's responsibilities relating to going concern may need to be adapted as necessary.[22] The description in the auditor's report of the auditor's responsibilities may also need to be adapted as necessary depending on how section 570 applies in the circumstances of the engagement.[23] [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A19 Appendix A, "Overview of Reporting Requirements," provides an overview of the reporting requirements depending on the special purpose framework. The exhibit, "Illustrations of Auditor's Reports on Special Purpose Financial Statements," contains illustrations of auditor's reports on special purpose financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Application of Section 700 or Section 703 When Reporting on Special Purpose Financial Statements

.A20 Paragraph .15 of this section requires the auditor to apply the requirements in section 700 or section 703 when forming an opinion and reporting on special purpose financial statements. In doing so, the auditor is also required to apply the reporting requirements in other AU-C sections and may find the special considerations addressed in paragraphs .A18 and .A21–.A22 of this section helpful. [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

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[22] Paragraph .32*b* of section 700.

[23] Paragraph .36*e* of section 700.

Key Audit Matters

.A21 For audits of special purpose financial statements, section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies only when the auditor is engaged to communicate key audit matters. [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Other Information

.A22 Section 720 addresses the auditor's responsibilities relating to other information in an entity's annual report. In the context of this section, an annual report is a document or combination of documents, the purpose of which is to provide owners (or similar stakeholders) with information on matters presented in the special purpose financial statements. The term similar stakeholders includes specific users whose financial information needs are met by the special purpose framework used to prepare the special purpose financial statements. When the auditor determines that the entity has issued or plans to issue an annual report, the requirements in section 720 apply to the audit of the special purpose financial statements. [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Forming an Opinion and Reporting Considerations (Ref: par. .14)

Description of the Applicable Financial Reporting Framework (Ref: par. .16–.17)

.A23 Terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP. Accordingly, the auditor is required by paragraph .16 to evaluate whether the financial statements are suitably titled. For example, cash basis financial statements might be titled as a statement of assets and liabilities arising from cash transactions or as a statement of revenue collected and expenses paid; a financial statement prepared on a regulatory basis of accounting might be titled as a statement of income — regulatory basis. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A24 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently under the special purpose framework than they would be under U.S. GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Fair Presentation (Ref: par. .18)

.A25 Financial statements that achieve a fair presentation include all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation. Also refer to paragraph .A12. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A26 When the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, informative disclosures similar to those required by GAAP are necessary to achieve fair presentation. For example, financial statements prepared on a tax basis or on a modified cash basis of accounting usually reflect depreciation, long-term debt, and owners' equity. Thus, the informative disclosures for depreciation, long-term debt, and owners' equity in such financial statements would be comparable to those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A27 Disclosures in special purpose financial statements may substitute qualitative information for some of the quantitative information required by GAAP or may provide information that communicates the substance of those requirements. For example, disclosing estimated percentages of revenues, rather than amounts that GAAP presentations would require, may sufficiently convey the significance of sales or leasing to related parties or major customers. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A28 The auditor is also required by paragraph .18*b* to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the special purpose financial statements to achieve fair presentation. For example, these disclosures may include matters about related party transactions, restrictions on assets and owners' equity, subsequent events, and significant uncertainties. In such circumstances, the special purpose financial statements would include the same disclosure required by GAAP or disclosure that communicates the substance of those requirements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A29 Appendix B, "Fair Presentation and Adequate Disclosures," provides additional guidance on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Auditor's Report (Ref: par. .18b)

.A30 When the special purpose financial statements are prepared in accordance with a regulatory or contractual basis of accounting or an other basis of accounting that requires an alert that restricts the use of the auditor's report pursuant to paragraph .06*a–b* of section 905, the auditor is required by paragraph .19*a* to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the special purpose financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .20)

.A31 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .20 requires the auditor to include an *emphasis-of-matter* paragraph in the auditor's report that alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Restricting the Use of the Auditor's Report in an Other-Matter Paragraph (Ref: par. .21)

.A32 Special purpose financial statements prepared in accordance with a contractual or regulatory basis of accounting are suitable only for a limited number of users who can be presumed to have an adequate understanding of such bases of accounting. For example, special purpose financial statements prepared in accordance with a contractual basis of accounting are developed for and directed only to the parties to the contract or agreement. Accordingly, the alert that restricts the use of the auditor's report is required due to the nature of the report and the potential for the report to be taken out of the context in which the auditor's report was intended to be used. Section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, addresses adding other parties as specified parties. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A33 In the case of special purpose financial statements prepared in accordance with a cash or tax basis of accounting, the auditor may consider it necessary in the circumstances of the engagement to include an alert that restricts the use of the auditor's report. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Regulatory Basis Financial Statements Intended for General Use (Ref: par. .22)

.A34 Special purpose financial statements prepared in accordance with a regulatory basis of accounting may be intended for general use. Such special purpose financial statements are intended for general use when the financial statements together with the auditor's report are intended for use by parties other than those within the entity and the regulatory agencies to whose jurisdiction the entity is subject or when the financial statements together with the auditor's report are distributed by the entity to parties other than the regulatory agencies to whose jurisdiction the entity is subject, either voluntarily or upon specific request. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Auditor's Report Prescribed by Law or Regulation (Ref: par. .23–.24)

.A35 The auditor may be required to comply with legal or regulatory requirements in addition to GAAS. When this is the case, the auditor may be required to use a layout, form, or wording in the auditor's report that differs from that described in this section, such as when printed forms or schedules designed or adopted by the bodies with which they are to be filed prescribe the wording of the auditor's report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A36 When the differences between the legal or regulatory requirements and GAAS relate only to the layout, form, and wording of the auditor's report and, at a minimum, each of the elements identified in paragraph .23 are included in the auditor's report, the auditor's report may refer to GAAS. Accordingly, in such circumstances the auditor is considered to have complied with the requirements of GAAS, even when the layout, form, and wording used in the auditor's report are specified by legal or regulatory reporting requirements. Section 210A addresses circumstances in which law or regulation prescribes the layout, form, or wording of the auditor's report in terms that are significantly different from the requirements of GAAS.[24]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A37 Some report forms can be made acceptable by inserting additional wording to include the elements identified in paragraph .23. Other report forms can be made acceptable only by complete revision because the prescribed language of the report calls for statements by the auditor that are not consistent with the auditor's function or responsibility; for example, a report form that requests the auditor to certify the financial statements. [Paragraph

[24]Paragraph .18 of section 210A. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 132, February 2017. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A38 This guidance can be applied to other circumstances, for example, reports on financial statements prepared in accordance with a general purpose framework for which a specific layout, form, or wording of the auditor's report is required. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Appendix A — Overview of Reporting Requirements

.A39 The following table provides an overview of the reporting requirements depending on the special purpose framework:

	Cash Basis	Tax Basis	Regulatory Basis	Regulatory Basis (General Use)	Contractual Basis	Other Basis
Opinion(s)	Single opinion on special purpose framework	Single opinion on special purpose framework	Single opinion on special purpose framework	Dual opinion on special purpose framework and generally accepted accounting principles[1]	Single opinion on special purpose framework	Single opinion on special purpose framework
Description of purpose for which special purpose financial statements are prepared[2]	No	No	Yes	Yes	Yes	As required by paragraph .19*a*(ii)
Emphasis-of-matter paragraph alerting readers regarding the preparation in accordance with a special purpose framework[3]	Yes	Yes	Yes	No	Yes	Yes
Other-matter paragraph including an alert restricting the use of the auditor's report[4]	No	No	Yes	No	Yes	As required by paragraph .21c[5]
Exhibit A Illustrations	1	2	3	4	5	

[1]Paragraph .22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Subsequently renumbered by issuance of SAS No. 139, March 2020.]

[2]Paragraph .19*a*ii. [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[3]Paragraphs .20 and .22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[4]Paragraphs .21–.22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[5]Paragraph .06*a*–*b* of section 905. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Appendix B — Fair Presentation and Adequate Disclosures (Ref: par. .A25–.A28)

.A40 When special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with generally accepted accounting principles (GAAP), paragraph .18 requires the auditor to evaluate whether, the financial statements include informative disclosures similar to those required by GAAP. The auditor is also required to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation. This appendix provides guidance, in addition to paragraphs .A25–.A28, on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements.

If special purpose financial statements contain items for which GAAP would require disclosure, the financial statements may either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure. Likewise, if GAAP sets forth requirements that apply to the presentation of financial statements, special purpose financial statements may either comply with those requirements or provide information that communicates the substance of those requirements, without modifying the format of the special purpose financial statements. This may result in substituting qualitative information for some of the quantitative information required for GAAP presentations, as in the following examples:

- Disclosure of the repayment terms of significant long-term borrowings may sufficiently communicate information about future principal reduction without providing the summary of principal reduction during each of the next five years.
- Information about the effects of accounting changes, discontinued operations, and extraordinary items, if applicable, could be disclosed in a note to the financial statements without following the GAAP presentation requirements in the statement of results of operations, using those terms, or disclosing net-of-tax effects.[1]
- Instead of showing expenses by their functional classifications in certain industries, a statement of activities could present expenses according to their natural classifications, and a note to the statement could use estimated percentages to communicate information about expenses incurred by the major program and supporting services.
- Instead of showing the amounts of, and changes in, classes of net assets without donor-imposed restrictions and with donor-imposed restrictions in certain industries, a statement of assets and liabilities could report total net assets, a related statement of activities could report changes in those totals, and a note to the financial statements

[1]FASB Accounting Standards Update (ASU) No. 2015-01 eliminated the concept of extraordinary items. However, GASB generally accepted accounting principles still retain this concept. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

could provide information, using estimated or actual amounts or percentages, about the restrictions on those amounts and on any deferred restricted amounts, describe the major restrictions, and provide information about significant changes in restricted amounts.[2]

For special purpose financial statements, GAAP disclosure requirements that are not relevant to the measurement of the item need not be considered, as illustrated by the following:

- Fair value disclosures for debt and equity securities would not be relevant when the basis of presentation does not adjust the cost of such securities to their fair value.
- For a sponsor of a defined benefit plan, disclosures related to actuarial calculations for contributions to defined benefit plans would not be relevant in financial statements prepared in accordance with the cash or tax basis of accounting.
- Disclosures related to the use of estimates would not be relevant in a presentation that has no estimates.

Special purpose financial statements may not include a statement of cash flows. If a presentation of cash receipts and disbursements is presented in a format similar to a statement of cash flows or if the entity chooses to present such a statement, the statement would either conform to the requirements for a GAAP presentation or communicate their substance. As an example, the statement of cash flows might disclose noncash acquisitions through captions on its face.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[2]FASB ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Exhibit — Illustrations of Auditor's Reports on Special Purpose Financial Statements (Ref: par. .A18)

.A41

Illustration 1 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Illustration 2 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 3 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Not Intended for General Use)

Illustration 4 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Intended for General Use)

Illustration 5 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

Illustration 1 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the cash basis of accounting (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.[1]

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of Financial Statements[2]

Opinion

We have audited the financial statements of ABC Partnership, which comprise the statement of assets and liabilities arising from cash transactions as of December 31, 20X1, and the related statement of revenue collected and expenses paid for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets and liabilities arising from cash transactions of ABC Partnership as of December 31, 20X1, and its revenue collected and expenses paid during the year then ended in accordance with the cash basis of accounting described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Partnership, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[3]

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the cash basis of accounting, which

[1]If management does not have a choice of financial reporting frameworks, the auditor is not required by paragraph .19*b* to make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[2]The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

[3]Another appropriate heading may be used.

is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the cash basis of accounting described in Note X, and for determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed.[4]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

[4]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Partnership's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of a partnership in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Based on the partnership agreement, management does not have a choice of financial reporting frameworks.[1]

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Partnership, which comprise the statements of assets, liabilities, and capital—income tax basis as of December 31, 20X1, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets, liabilities, and capital of ABC Partnership as of December 31, 20X1, and its revenue and expenses and changes in partners' capital accounts for the year then ended in accordance with the basis of accounting ABC Partnership uses for income tax purposes described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Partnership, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[3]

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[1]If management has a choice of financial reporting frameworks, paragraph .18*b* requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[2]The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the basis of accounting ABC Partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the basis of accounting ABC Partnership uses for income tax purposes and for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed.[4]

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[3]Another appropriate heading may be used.

[4]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Partnership's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Not Intended for General Use)

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity (that is, a special purpose framework).
- The financial statements together with the auditor's report are not intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.[1]

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Government Authority, which comprise the statement of net position—regulatory basis as of December 31, 20X1, and the related statements of revenues, expenses, and changes in net position — regulatory basis; and statement of cash flows — regulatory basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20XX, and the regulatory basis changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section

[1]If management has a choice of financial reporting frameworks, paragraph .18*b* requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[2]The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

of our report. We are required to be independent of ABC Government Authority and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[3]

We draw attention to Note X of the financial statements, which describes the basis of accounting. As described in Note X to the financial statements, the financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State Statutes. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements[4]

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes. Management is also responsible for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive

[3] Another appropriate heading may be used.

[4] The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed.[5]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Government Authority's ability to continue as a going concern for a reasonable period of time.

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

Restriction on Use[6]

Our report is intended solely for the information and use of ABC Government Authority and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[5]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed."

[6]Another appropriate heading may be used.

Illustration 4 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Intended for General Use)

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity (that is, a special purpose framework).
- The regulatory basis financial statements together with the auditor's report are intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.[1]
- The variances between the regulatory basis of accounting and accounting principles generally accepted in the United States of America (U.S. GAAP) are not reasonably determinable and are presumed to be material.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinions

We have audited the financial statements of ABC Government Authority, which comprise the statement of net position—regulatory basis as of December 31, 20X1, and the related statements of revenues, expenses, and changes in net position—regulatory basis and cash flows—regulatory basis for the year then ended, and the related notes to the financial statements.

Unmodified Opinion on Regulatory Basis of Accounting

In our opinion, the accompanying financial statements present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20X1, and the regulatory basis revenues, expenses, and changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

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[1] If management has a choice of financial reporting frameworks, paragraph .18*b* requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[2] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles section of our report, the financial statements do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of ABC Government Authority as of December 31, 20X1, or the changes in net position and cash flows thereof for the year then ended.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Government Authority, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note X of the financial statements, the financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State Statutes. The effects on the financial statements of the variances between the regulatory basis of accounting described in Note X and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material and pervasive.

Responsibilities of Management for the Financial Statements[3]

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes. Management is also responsible for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than

[3]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed.[4]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Government Authority's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[*Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[4]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

Illustration 5 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a contractual basis of accounting (that is, a special purpose framework) to comply with the provisions of that contract.
- Based on the provisions of the contract, management does not have a choice of financial reporting frameworks.[1]

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Company, which comprise the assets and liabilities — contractual basis as of December 31, 20X1, and the revenues and expenses — contractual basis, changes in equity — contractual basis, and cash flows — contractual basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets and liabilities of ABC Company as of December 31, 20X1, and revenues, expenses, changes in equity, and cash flows for the year then ended in accordance with the financial reporting provisions of Section Z of the contract between ABC Company and DEF Company dated January 1, 20X1 (the contract).

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[3]

[1]If management has a choice of financial reporting frameworks, paragraph .18*b* requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[2]The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared by ABC Company on the basis of the financial reporting provisions of Section Z of the contract, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the contract referred to above. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements[4]

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of Section Z of the contract. Management is also responsible for 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 Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[5]

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[3]Another appropriate heading may be used.

[4]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Restriction on Use[6]

Our report is intended solely for the information and use of ABC Company and DEF Company and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

[5]In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[6]Another appropriate heading may be used.

AU-C Section 805

Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement

Source: SAS No. 122; SAS No. 139; SAS No. 145.

See section 9805 for interpretations of this section.

Effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2012, unless otherwise indicated.

Note

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 AU-C sections 200–700 apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This section addresses special considerations in the application of those AU-C sections to an audit of a single financial statement or of a specific element, account, or item of a financial statement. The single financial statement or the specific element, account, or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, also applies to the audit. (Ref: par. .A1–.A4)

.02 This section does not apply to the report of a component auditor issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see section 600A, *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]*).

.03 This section does not override the requirements of the other AU-C sections nor does it purport to address all special considerations that may be relevant in the circumstances of the engagement.

Effective Date

.04 This section is effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2012.

Objective

.05 The objective of the auditor, when applying generally accepted auditing standards (GAAS) in an audit of a single financial statement or of a specific element, account, or item of a financial statement, is to address appropriately the special considerations that are relevant to

a. the acceptance of the engagement;

b. the planning and performance of that engagement; and

c. forming an opinion and reporting on the single financial statement or the specific element, account, or item of a financial statement.

Definitions

.06 For purposes of this section, reference to

a. an *element of a financial statement* or an *element* means an *element, account, or item of a financial statement*. (Ref: par. .A5)

b. a *single financial statement* or a *specific element of a financial statement* includes the related disclosures. (Ref: par. A2)

[As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.07 Reference to *generally accepted accounting principles* (GAAP) in GAAS means GAAP promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 203 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Considerations When Accepting the Engagement

Application of GAAS (Ref: par. .A6–.A8)

.08 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AU-C sections relevant to the audit.[1] In the case of an audit of a single financial statement or a specific element of a financial statement, this requirement applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements.

.09 If the auditor is not also engaged to audit the entity's complete set of financial statements, the auditor should determine whether the audit of a single financial statement or a specific element of those financial statements in accordance with GAAS is practicable. The auditor should also determine whether the auditor will be able to perform procedures on interrelated items, as required by paragraph .13.

Acceptability of the Financial Reporting Framework (Ref: par. .A9–.A13)

.10 Section 210A, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.[2] In the case of an audit of a single financial statement or a specific element of a financial statement, the auditor should obtain an understanding of

a. the purpose for which the single financial statement or specific element of a financial statement is prepared,

b. the intended users, and

c. the steps taken by management to determine that the application of the financial reporting framework is acceptable in the circumstances.

.11 The auditor's determination required by paragraph .10 should include consideration of whether the application of the financial reporting framework will result in a presentation that provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the specific element and the effect of material transactions and events on the information conveyed in the financial statement or the specific element.

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[1]Paragraph .20 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[2]Paragraph .06*a* of section 210A, *Terms of Engagement*.

Considerations When Planning and Performing the Audit

.12 Section 200 states that GAAS is written in the context of an audit of financial statements; it is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.[3] In planning and performing the audit of a single financial statement or a specific element of a financial statement, the auditor should adapt all AU-C sections relevant to the audit as necessary in the circumstances of the engagement. (Ref: par. .A14–.A17)

.13 In the case of an audit of a single financial statement or a specific element of a financial statement, the auditor should perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element of a financial statement (Ref: par. .A18)

a. the auditor should, if the specific element is, or is based upon, the entity's stockholders' equity or the equivalent, perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion about financial position, excluding matters related to classification or disclosure that are not relevant to the audit of the specific element.

b. the auditor should, if the specific element is, or is based upon, the entity's net income or the equivalent, perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion about financial position and results of operations, excluding matters related to classification or disclosure that are not relevant to the audit of the specific element.

Materiality (Ref: par. .A19)

.14 Section 320, *Materiality in Planning and Performing an Audit*, requires the auditor to determine, when establishing the overall audit strategy, materiality for the financial statements as a whole.[4] In the case of an audit of a single financial statement, the auditor should determine materiality for the single financial statement being reported on rather than for the complete set of financial statements. In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

Forming an Opinion and Reporting Considerations

.15 When forming an opinion and reporting on a single financial statement or a specific element of a financial statement, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and when applicable, section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, adapted as necessary

[3]Paragraph .02 of section 200.

[4]Paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

in the circumstances of the engagement. (Ref: par. .A20–.A22) [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Reporting on the Entity's Complete Set of Financial Statements and a Single Financial Statement or a Specific Element of Those Financial Statements

.16 If, in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor undertakes an engagement to audit a single financial statement or a specific element of a financial statement, the auditor should

a. issue a separate auditor's report and express a separate opinion for each engagement.

b. indicate in the report on a specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading.

.17 Except as required by paragraph .21, an audited single financial statement or an audited specific element of a financial statement may be published together with the entity's audited complete set of financial statements, provided that the presentation of the single financial statement or the specific element is sufficiently differentiated from the complete set of financial statements. The auditor should also differentiate the report on the single financial statement or the specific element of a financial statement from the report on the complete set of financial statements.

.18 If the auditor concludes that the presentation of the audited single financial statement or the audited specific element does not differentiate it sufficiently from the complete set of financial statements, as described in paragraph .17, the auditor should ask management to remedy the situation. The auditor should not release the auditor's report containing the opinion on the single financial statement or the specific element of a financial statement until satisfied with the differentiation.

Considering the Implications of Certain Matters Included in the Auditor's Report on the Entity's Complete Set of Financial Statements

.19 If the auditor's report on an entity's complete set of financial statements includes a modified opinion, an emphasis-of-matter or other-matter paragraph, a going concern section, a communication of key audit matters, or a statement describing an uncorrected material misstatement of other information, the auditor should consider the implications, if any, that these matters have for the audit of the single financial statement or for the specific element of a financial statement and for the auditor's report thereon. (Ref: par. .A23–.A26) [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Modifications to the Opinion in the Independent Auditor's Report

.20 In the case of an audit of a specific element of a financial statement, if the auditor's modified opinion on the entity's complete set of financial statements as a whole is relevant to the audit of the specific element, the auditor should (Ref: par. .A27–.A29)

a. express an adverse opinion on the specific element when the modification of the auditor's opinion on the complete set of financial statements as a whole arises from a material misstatement in such financial statements.

b. disclaim an opinion on the specific element when the modification of the auditor's opinion on the complete set of financial statements as a whole arises from an inability to obtain sufficient appropriate audit evidence.

Adverse Opinion or Disclaimer of Opinion in the Auditor's Report on the Entity's Complete Set of Financial Statements

.21 If the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole, an unmodified opinion on a specific element in the same auditor's report would contradict the adverse opinion or disclaimer of opinion on the entity's complete set of financial statements as a whole and would be tantamount to expressing a piecemeal opinion. In the context of a separate audit of a specific element of 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

a. that opinion is expressed in an auditor's report that is neither published together with nor otherwise accompanies the auditor's report containing the adverse opinion or disclaimer of opinion and

b. the 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.

[As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.22 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 with nor otherwise accompanies the auditor's report containing the adverse opinion or disclaimer of opinion. (Ref: par. .A30)

.23 If the auditor's report on an entity's complete set of financial statements includes an emphasis-of-matter paragraph or an other-matter paragraph that is relevant to the audit of the single financial statement or the specific element, the auditor should include a similar emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the single financial statement or the specific element, in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. (Ref: par. .A29)

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles (Ref: par. .A31–.A32)

.24 When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, the auditor should include an emphasis-of-matter paragraph[5] in the auditor's report that

a. states the purpose for which the presentation is prepared and refers to a note in the financial statements that describes the basis of presentation and

b. indicates that the presentation is not intended to be a complete presentation of the entity's assets, liabilities, revenues, or expenses.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01 and .06*b*)

.A1 Section 200 defines the term *historical financial information* as information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A2 Section 200 defines the term *financial statements* as a structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.[6] [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

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[5]Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report.*

[6]Paragraph .14 of section 200.

.A3 Paragraph .A9 of section 200 provides guidance on what constitutes a complete set of financial statements and also provides the following examples of single financial statements, each of which would include related disclosures:

- Balance sheet
- Statement of income or statement of operations
- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owner's equity
- Statement of revenue and expenses
- Statement of operations by product lines

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A4 An attest engagement other than an audit of historical financial information is performed in accordance with Statements on Standards for Attestation Engagements. For example, AT-C section 215, *Agreed-Upon Procedures Engagements*, applies when reporting on the results of applying agreed-upon procedures to one or more specific elements of a financial statement, and AT-C section 210, *Review Engagements*, provides guidance when reporting on a review of one or more specific elements of a financial statement. Paragraph .A8 describes circumstances in which an engagement performed in accordance with the attestation standards may be more practicable than an audit performed in accordance with this section. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Definitions

Element of a Financial Statement (Ref: par. .06)

.A5 The appendix, "Examples of Specific Elements, Accounts, or Items of a Financial Statement," lists examples of an element of a financial statement. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Considerations When Accepting the Engagement

Application of GAAS (Ref: par. .08–.09)

.A6 Section 200 requires the auditor to comply with (*a*) relevant ethical requirements relating to financial statement audit engagements and (*b*) all AU-C sections relevant to the audit. It also requires the auditor to comply with each requirement of an AU-C section, unless, in the circumstances of the audit, the entire AU-C section is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement in an AU-C section by performing alternative audit procedures to achieve the intent of that requirement.[7] [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Complying With Relevant Requirements

.A7 Compliance with the requirements of AU-C sections relevant to the audit of a single financial statement or a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, the applicable financial reporting framework, and its internal control, as an auditor who also audits the entity's complete set of financial statements. The auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. Also see paragraph .A18. [Paragraph renumbered by the issuance of SAS No. 139, March 2020. As amended, effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2023, by SAS No. 145.]

.A8 In the case of an audit of a specific element of a financial statement, certain AU-C sections require audit work that may be disproportionate to the specific element being audited. For example, although the requirements of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, may be relevant in the circumstances of an audit of a schedule of accounts receivable (see paragraph .A14), complying with those requirements may not be practicable because of the audit effort required. If the auditor concludes that an audit of a single financial statement or a specific element of a financial statement in accordance with GAAS may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable, such as an engagement performed in accordance with the Statements on Standards for Attestation Engagements, as described in paragraph .A4. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Acceptability of the Financial Reporting Framework (Ref: par. .10–.11)

.A9 In the case of an audit of a single financial statement or a specific element of a financial statement, the financial information needs of the intended users are relevant in determining the acceptability of the financial reporting framework applied

[7] Paragraphs .16, .20, and .24–.26 of section 200.

in the preparation of the single financial statement or the specific element. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A10 A single financial statement or a specific element of a financial statement may be prepared in accordance with relevant requirements of a financial reporting framework established by an authorized or recognized standards-setting organization for the preparation of a complete set of financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP] or International Financial Reporting Standards promulgated by the International Accounting Standards Board). If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework that are relevant to the presentation of a single financial statement or a specific element of a financial statement that provides adequate disclosures. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A11 The determination of the acceptability of the applicable framework may also include consideration of the following:

- Whether the applicable financial reporting framework is explicitly or implicitly restricted to the preparation of a complete set of financial statements.
- Whether the single financial statement or the specific element of a financial statement will
  - — comply fully with each of those requirements of the framework relevant to the particular financial statement or the particular element and the presentation of the financial statement or the specific element of a financial statement, including the related disclosures. For example, when reporting on a schedule of long-term debt prepared in accordance with U.S. GAAP relevant to that schedule, the schedule of long-term debt, including the related notes, would be comparable to such information in financial statements prepared in accordance with U.S. GAAP.
  - — provide, if necessary to achieve fair presentation, disclosures beyond those specifically required by the framework or, in extremely rare circumstances, depart from a requirement of the framework.[8] A single financial statement or a specific element of a financial statement, including the related notes, that achieves a fair presentation includes all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation.

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[8] See paragraph .14 of section 200 for a definition of *financial reporting framework*.

.A12 The auditor may be requested to audit an incomplete presentation but one that is otherwise in accordance with GAAP. For example, an entity wishing to sell a division or product line may present certain assets and liabilities, revenues, and expenses relating to the division or product line being sold. Incomplete presentations may also be required by a regulatory agency or a contract or an agreement. For example, a regulatory agency may require a schedule of gross income and certain expenses of an entity's real estate operation in which income and expenses are measured in accordance with GAAP, but *expenses* are defined to exclude certain items, such as interest, depreciation, and income taxes. Also, an acquisition agreement may specify a schedule of gross assets and liabilities of the entity measured in accordance with GAAP but limited to the assets to be sold and liabilities to be transferred pursuant to the agreement. These types of presentations are generally regarded as single financial statements, even though certain items may be excluded only to the extent necessary to meet the purpose for which they were prepared. The requirement in paragraph .24 is designed to avoid misunderstandings about the purpose for which the presentation is prepared. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A13 As indicated in paragraph .A12, incomplete presentations may be required by a regulatory agency or a contract or an agreement. Paragraphs .A2–.A3 of section 800 provide guidance on the acceptability of the financial reporting framework when the regulatory or contractual basis of accounting is based on a general purpose framework, such as GAAP. The auditor may determine that it is more appropriate for the description of the applicable financial reporting framework to refer to the regulatory or contractual basis of accounting, rather than make reference to GAAP. As indicated in paragraph .01, if the presentation is prepared in accordance with a special purpose framework, section 800 also applies to the audit. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Considerations When Planning and Performing the Audit (Ref: par. .12–.13)

.A14 An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist.[9] Even when only a specific element of a financial statement is the subject of the audit, AU-C sections such as section 240, *Consideration of Fraud in a Financial Statement Audit*, section 550, *Related Parties*, and section 570 are, in principle, relevant. This is because the specific element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern assumption under the applicable financial reporting framework. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A15 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to determine the appropriate person or persons within the entity's governance structure with whom to communicate. Section 260 notes that, in some cases, all

[9] Paragraph .20 of section 200.

of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this circumstance. When a complete set of financial statements is also prepared by the entity, the person or persons responsible for oversight of the preparation of the single financial statement or the element may not be the same as those responsible for the oversight of the preparation of the complete set of financial statements. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A16 Furthermore, GAAS is written in the context of an audit of financial statements; it is to be adapted as necessary in the circumstances when applied to the audit of a single financial statement or a specific element of a financial statement.[10] For example, written representations from management about the complete set of financial statements would be replaced by written representations about the presentation of the single financial statement or the specific element, in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A17 Matters included in the auditor's report on the complete set of financial statements may have implications for the audit of a single financial statement or of an element of a financial statement (see paragraph .19). When planning and performing an audit of a single financial statement or a specific element of a financial statement in conjunction with the audit of the entity's complete set of financial statements, the auditor may use audit evidence obtained as part of the audit of the entity's complete set of financial statements in the audit of the single financial statement or the specific element. GAAS, however, requires the auditor to plan and perform the audit of the single financial statement or specific element to obtain sufficient appropriate audit evidence on which to base the opinion on the single financial statement or the specific element. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A18 The individual financial statements that make up a complete set of financial statements, and many of the specific elements of those financial statements, including their related disclosures, are interrelated. For example, sales and receivables, inventory and payables, and buildings and equipment and depreciation each are interrelated. Accordingly, when auditing a single financial statement or a specific element of a financial statement, the auditor may not be able to consider the single financial statement or the specific element in isolation. Consequently, paragraph .13 requires the auditor to perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element that is, or is based upon, the entity's stockholders' equity or net income (or the equivalents thereto), paragraph .13 requires the auditor to perform procedures necessary to obtain sufficient appropriate audit evidence about financial position, or financial position and results of operations, respectively, because of the interrelationship between the specific element and the balance sheet accounts and the income statement accounts. However, matters related to classification or disclosure may not be relevant to the audit of the specific element; therefore, audit procedures on such

[10]Paragraph .02 of section 200.

matters may not be necessary in an audit of a specific element. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Materiality (Ref: par. .14)

.A19 The materiality determined for a single financial statement or a specific element of a financial statement differs from the materiality determined for the entity's complete set of financial statements; this will affect the nature, timing, and extent of the audit procedures and the evaluation of uncorrected misstatements. In the case of an audit of a single financial statement, paragraph .14 requires the auditor to determine materiality for the single financial statement being reported on rather than for the complete set of financial statements. In the case of an audit of one or more specific elements of a financial statement, the auditor's opinion is on each of the specific elements; therefore, paragraph .14 requires the auditor to determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements. Consequently, an audit of one or more specific elements of a financial statement is usually more extensive than if the same information was being considered in conjunction with an audit of the complete set of financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Forming an Opinion and Reporting Considerations (Ref: par. .15)

.A20 Sections 700 and 703 require the auditor, in forming an opinion, to evaluate whether 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.[11] In the case of an audit of a single financial statement or a specific element of a financial statement, it is important, in view of the requirements of the applicable financial reporting framework, that the disclosures enable the intended users to understand

- the information conveyed in the financial statement or the specific element and
- the effect of material transactions and events on the information conveyed in the financial statement or the specific element.

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Going Concern

.A21 The applicable financial reporting framework may not specifically address whether management is required to make a going concern assessment for a single financial

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[11]Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .37 of section 703. [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

statement or a specific element, account, or item of a financial statement. Therefore, the description in the auditor's report of management's responsibilities relating to going concern[12] may not be relevant or may need to be adapted as necessary. The description in the auditor's report of the auditor's responsibilities[13] relating to going concern may also need to be adapted as necessary depending on whether section 570 is determined to be relevant to the audit in accordance with paragraph .12. In making that determination, the auditor may consider whether the auditor's responsibilities relating to going concern are likely to be relevant to users for the intended purpose of the single financial statement or specific element, account, or item of a financial statement presented. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A22 The exhibit, "Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statements," contains illustrations of auditor's reports. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Considering the Implications of Certain Matters Included in the Auditor's Report on the Entity's Complete Set of Financial Statements (Ref: par. .19–.23)

.A23 Considering whether a matter included in the auditor's report on the complete set of financial statements is relevant in the context of an engagement to report on a single financial statement or a specific element of a financial statement involves professional judgment. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A24 Factors that may be relevant in considering those implications include the following:

- The nature of the matters described in the auditor's report on the complete set of financial statements and the extent to which they relate to what is included in the single financial statement or a specific element of a financial statement
- The pervasiveness of the matters described in the auditor's report on the complete set of financial statements
- The nature and extent of the differences between the applicable financial reporting frameworks
- The extent of the difference between the periods covered by the complete set of the financial statements compared with the periods or dates of the single financial statement or element of a financial statement

[12]Paragraph .32*b* of section 700. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[13]Paragraph .36*e* of section 700. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

- The time elapsed since the date of the auditor's report on the complete set of the financial statements

[Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A25 When applicable, key audit matters communicated in the auditor's report on a complete set of financial statements may have implications for an audit of a single financial statement or specific element of a financial statement. The information included in the "Key Audit Matters" section about how the matter was addressed in the audit of a complete set of financial statements may be useful to the auditor's determination of how to address the matter when it is relevant to an audit of a single financial statement or specific element of a financial statement. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A26 If the auditor is engaged to communicate key audit matters in the auditor's report on a single financial statement or a specific element of a financial statement, section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies in its entirety. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Modifications to the Opinion in the Independent Auditor's Report (Ref: par. .20 and .23)

.A27 In the case of an audit of a specific element of a financial statement, if the opinion in the auditor's report on an entity's complete set of financial statements is modified and the modification is relevant to the audit of the specific element, the modification is material and pervasive with respect to the specific element. Modifications related to an interrelated item of the specific element may also be relevant to the audit of the specific element. Conversely, modifications related solely to classification or disclosure may not be relevant to the audit of the specific element. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A28 For example, when there is a qualification of the auditor's opinion in relation to accounts receivable in the auditor's report on the complete set of financial statements and the single financial statement includes accounts receivable or the specific element of a financial statement relates to accounts receivable, there likely would be implications for the audit. On the other hand, if the qualification of the auditor's opinion on the complete set of financial statements relates to classification of long-term debt, then it is less likely that there would be implications for an audit of the single financial statement that is the income statement, or if the specific element of the financial statement relates to accounts receivable. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A29 Even when certain matters included in the auditor's report on the entity's complete set of financial statements do not have implications for the audit of, or for the auditor's report on, the single financial statement or the specific element of a financial statement, the auditor may deem it appropriate to refer to the matter in an other-matter paragraph in an auditor's report on the single financial statement or on the specific element of a financial statement (see section 706). For example, the auditor may consider it appropriate to refer in the auditor's report on the single financial statement or the specific element of a financial statement to a going concern section included in the auditor's report on the complete set of financial statements. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Adverse Opinion or Disclaimer of Opinion in the Auditor's Report on the Entity's Complete Set of Financial Statements (Ref: par. .22)

.A30 In the auditor's report on an entity's complete set of financial statements, the expression of a disclaimer of opinion regarding the results of operations and cash flows, when relevant, and an unmodified opinion regarding the financial position are permitted because the disclaimer of opinion is being issued on the results of operations and cash flows only and not on the financial statements as a whole.[14] [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With GAAP (Ref: par. .24)

.A31 As described in paragraph .A12, the auditor may be requested to audit an incomplete presentation but one that is otherwise in accordance with GAAP. When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, paragraph .24 requires the auditor to include an emphasis-of-matter paragraph in the auditor's report, which alerts users as to the purpose of the presentation and that the presentation is incomplete. The exhibit illustrates such a paragraph. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A32 If the presentation is prepared in accordance with a regulatory or contractual basis of accounting, the requirement in paragraph .24 does not apply. In such circumstances, refer to section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. See also paragraph .A13 of this section. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[14] Paragraph .A17 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, and paragraph .A17 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Appendix — Examples of Specific Elements, Accounts, or Items of a Financial Statement (Ref: par. .A5)

.A33 The following are examples of specific elements, accounts, or items of a financial statement:

- Accounts receivable; allowance for doubtful accounts receivable; inventory; the liability for accrued benefits of a private benefit plan; the recorded value of identified intangible assets; or the liability for incurred but not reported claims in an insurance portfolio, including related notes
- A schedule of externally managed assets and income of a private benefit plan, including related notes
- A schedule of disbursements regarding a lease property, including related notes
- A schedule of profit participation or employee bonuses, including related notes

Exhibit — Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement (Ref: par. .A22 and .A31)

.A34

Illustration 1 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a General Purpose Framework

Illustration 2 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a Special Purpose Framework

Illustration 3 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a General Purpose Framework

Illustration 4 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a Special Purpose Framework

Illustration 5 — An Auditor's Report on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles

Illustration 1 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a General Purpose Framework

Circumstances include the following:

- Audit of a balance sheet (that is, a single financial statement).
- The balance sheet has been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statement[1]

Opinion

We have audited the balance sheet of ABC Company as of December 31, 20X1, and the related notes (the financial statement).[2]

In our opinion, the accompanying financial statement presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statement[3]

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control

[1] The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] The auditor may refer to the financial statement as the *balance sheet*.

[3] The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the financial statement as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statement.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statement, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statement.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.[4]

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

Report on Other Legal and Regulatory Requirements

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[4]This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a Special Purpose Framework

Circumstances include the following:

- Audit of a statement of cash receipts and disbursements (that is, a single financial statement).
- The financial statement has been prepared by management of the entity in accordance with the cash basis of accounting (a special purpose framework) to respond to a request for cash flow information received from a creditor.[1]
- Management has a choice of financial reporting frameworks.[2]

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Report on the Audit of the Financial Statement[3]

Opinion

We have audited the statement of cash receipts and disbursements of ABC Company for the year ended December 31, 20X1, and the related notes (the financial statement).[4]

In our opinion, the accompanying financial statement presents fairly, in all material respects, the cash receipts and disbursements of ABC Company for the year ended December 31, 20X1, in accordance with the cash basis of accounting described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[5]

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[1]Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

[2]Paragraph .19*b* of section 800.

[3]The subtitle "Report on the Financial Statement" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[4]The auditor may refer to the financial statements as the *statement of cash receipts and disbursements*.

We draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statement[6]

Management is responsible for the preparation and fair presentation of the financial statement in accordance with the cash basis of accounting described in Note X, and for determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the financial statement as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of certain internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statement.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statement, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose

[5]Another appropriate heading may be used.

[6]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statement.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.[7]

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[7]This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Illustration 3 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a General Purpose Framework

Circumstances include the following:

- Audit of a schedule of accounts receivable (that is, a specific element, account, or item of a financial statement).
- The schedule of accounts receivable has been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America.
- The audit of the schedule of accounts receivable was performed in conjunction with an engagement to audit the entity's complete set of financial statements. The opinion on those financial statements was not modified, and the report did not include an emphasis-of-matter paragraph or other-matter paragraph.[1]
- Management determined that the going concern assessment in accounting principles generally accepted in the United States of America does not apply to the preparation of the schedule of accounts receivable. Although a going concern assessment was made in the preparation of the entity's complete set of financial statements from which the financial information being reported on has been derived, the going concern assessment period is significantly different because the schedule of accounts receivable is anticipated to be issued several months after the full set of financial statements were issued. The auditor agrees with management's determination regarding the applicability of the going concern assessment to the preparation of the schedule of accounts receivable.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Schedule[2]

Opinion

We have audited the schedule of accounts receivable of ABC Company as of December 31, 20X1, and the related notes (the schedule).[3]

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[1]If the auditor undertakes an engagement to audit a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, paragraph .16*b* requires the auditor to indicate in the report on the specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[2]The subtitle "Report on the Audit of the Schedule" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

In our opinion, the accompanying schedule presents fairly, in all material respects, the accounts receivable of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedule section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Schedule[4]

Management is responsible for the preparation and fair presentation of the schedule in accordance with accounting principles generally accepted in the United States of America and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the schedule as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedule.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks.

[3]The auditor may refer to the schedule as the *schedule of accounts receivable*. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

[4]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedule.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the schedule.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.[5]

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

Other Matter

We have audited, in accordance with GAAS, the financial statements of ABC Company as of and for the year ended December 31, 20X1, and our report thereon, dated March 15, 20X2, expressed an unmodified opinion on those financial statements.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[5]This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Illustration 4 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a Special Purpose Framework

Circumstances include the following:

- Audit of a schedule of royalties applicable to engine production (that is, a specific element, account, or item of a financial statement).
- The financial information has been prepared by management of the entity in accordance with a contractual basis of accounting (that is, a special purpose framework) to comply with the provisions of that contract.[1]
- Based on the provisions of the contract, management does not have a choice of financial reporting frameworks.[2]
- The audit of the schedule was not performed in conjunction with an engagement to audit the entity's complete set of financial statements.[3]

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Schedule[4]

Opinion

We have audited the schedule of royalties applicable to engine production of the Q Division of ABC Company for the year ended December 31, 20X1, and the related notes (the schedule).[5]

In our opinion, the accompanying schedule presents fairly, in all material respects, the royalties applicable to engine production of the Q Division of ABC Company for the year ended December 31, 20X1, in accordance with the financial reporting provisions of Section Z of the license agreement between ABC Company and XYZ Corporation dated January 1, 20X1 (the contract).

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[1]Section 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

[2]Paragraph .19*b* of section 800.

[3]If the auditor undertakes an engagement to audit a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, paragraph .16 requires the auditor to indicate in the report on the specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading.

[4]The subtitle "Report on the Schedule" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[5]The auditor may refer to the schedule as the *schedule of royalties*.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedule section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting[6]

We draw attention to Note X to the schedule, which describes the basis of accounting. The schedule was prepared by ABC Company on the basis of the financial reporting provisions of Section Z of the contract, which is a basis of accounting other than accounting principles generally accepted in the United States of America. As a result, the schedule may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Schedule[7]

Management is responsible for the preparation and fair presentation of the schedule in accordance with the financial reporting provisions of Section Z of the contract, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the schedule as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedule.

In performing an audit in accordance with GAAS, we:

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[6] Another appropriate heading may be used.

[7] The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the schedule.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.[8]

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

Other-Matter Paragraph — Restriction on Use[9]

Our report is intended solely for the information and use of ABC Company and XYZ Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[8]This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[9]Another appropriate heading may be used. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Illustration 5 — An Auditor's Report on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles

Circumstances include the following:

- Audit of the historical summaries of gross income and direct operating expenses (that is, a single financial statement).
- The historical summaries have been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America but are an incomplete presentation of revenues and expenses.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Historical Summaries[1]

Opinion

We have audited the Historical Summaries of Gross Income and Direct Operating Expenses of ABC Apartments for each of the three years in the period ended December 31, 20X1, and the related notes (the historical summaries).[2]

In our opinion, the accompanying historical summaries present fairly, in all material respects, the gross income and direct operating expenses described in Note X of ABC Apartments for each of the three years in the period ended December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Historical Summaries section of our report. We are required to be independent of ABC Apartments and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting

We draw attention to Note X to the historical summaries, which describes that the accompanying historical summaries were prepared for the purpose of complying with the

[1] The subtitle "Report on the Audit of the Historical Summaries" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] The auditor may refer to the historical summaries as the *financial statement*.

rules and regulations of Regulator DEF (for inclusion in the filing of Form Z of ABC Company) and are not intended to be a complete presentation of the Company's revenues and expenses. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Historical Summaries[3]

Management is responsible for the preparation and fair presentation of the historical summaries in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the historical summaries that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Historical Summaries

Our objectives are to obtain reasonable assurance about whether the historical summaries as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the historical summaries.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the historical summaries, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the historical summaries.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.

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[3]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the historical summaries.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.[4]

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

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

[4]This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

AU-C Section 9805

Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement: Auditing Interpretations of Section 805

1. Auditor of Governmental Cost-Sharing Multiple-Employer Pension Plan

.01 *Question* — Management of a governmental cost-sharing multiple-employer pension plan (cost-sharing plan or plan) has calculated and prepared a schedule of employer allocations and a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. If the plan auditor is engaged to perform an audit on schedules such as those illustrated in exhibit 1, "Schedule of Employer Allocations," and either exhibit 2(a), "Schedule of Pension Amounts by Employer," or exhibit 2(b), "Schedule of Collective Pension Amounts," of this interpretation, what type of audit report may be issued?

.02 *Interpretation* — Because the amounts contained in the previously mentioned schedules are considered elements or items of the cost-sharing plan or participating employer's financial statements, the elements included in these schedules may be audited under section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. An illustrative auditor's report on the schedule of employer allocations and schedule of pension amounts by employer prepared pursuant to section 805 follows.

Independent Auditor's Report

[*Appropriate Addressee*]

Opinions[1,2]

We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the total for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense (specified column totals) included in the accompanying schedule of pension amounts by employer of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.

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[1]If the plan prepares a schedule of pension amounts by employer and specific liabilities of individual employers, as defined in paragraph 56 of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27*, exist and are not displayed in the schedule, the "Opinions" section would be changed as follows:

> We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the columns titled
>
> net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense excluding specific liabilities of individual employers (specified column totals) included in the accompanying schedule of collective pension amounts of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.
>
> In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense excluding specific liabilities of individual employers for the total of all participating entities for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

[2]If the plan prepares a schedule of collective pension amounts as illustrated in exhibit 2(b), "Schedule of Collective Pension Amounts," of this interpretation instead of the schedule of pension amounts by employer as illustrated in exhibit 2(a), "Schedule of Pension Amounts by Employer," of this interpretation, the "Opinions" section would be changed as follows:

> We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the columns titled net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense (specified column totals) included in the accompanying schedule of collective pension amounts of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.
>
> In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and total pension expense for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

Additionally, if specific liabilities of individual employers, as defined in paragraph 56 of GASB Statement No. 68, exist but are excluded from the schedule, the paragraphs in this section would refer to pension expense excluding that attributable to specific liabilities of individual employers rather than pension expense.

In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the total of all participating entities for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedules section of our report. We are required to be independent of ABC Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Schedules

Management is responsible for the preparation and fair presentation of these schedules in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedules that are free from material misstatement, whether due to fraud or error.[3]

Auditor’s Responsibilities for the Audit of the Schedules

Our objectives are to obtain reasonable assurance about whether the schedules are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedules.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedules, whether due to fraud or error, and design and perform audit procedures responsive to those risks.

[3]The description of management’s responsibilities relating to going concern required by paragraph .32*b* of section 700, *Forming an Opinion and Reporting on Financial Statements*, may need to be included in this section of the report, or as stated in paragraph .A21 of section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, may not be relevant or may need to be adapted as necessary. See paragraph .A21 of section 805.

Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedules.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Pension Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the schedules.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Pension Plan's ability to continue as a going concern for a reasonable period of time.

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

Other Matter

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of ABC Pension Plan as of and for the year ended June 30, 20X5, and our report thereon, dated October 15, 20X5, expressed an unmodified opinion on those financial statements.

Restriction on Use

Our report is intended solely for the information and use of ABC Pension Plan management, [*identify the body or individuals charged with governance of ABC Pension Plan*], ABC Pension Plan employers and their auditors and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

.03 *Question* — In planning and performing an audit of the schedules illustrated in exhibits 1 and 2(a) or exhibit 2(b) of this interpretation, may the plan auditor use the same materiality as used for the audit of the plan's basic financial statements?

.04 *Interpretation* — No. Section 805 states, in part:[4]

[4]Paragraph .14 of section 805.

In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

Accordingly, the plan auditor should determine materiality separately for the schedule of employer allocations as well as each of the elements upon which the auditor opines from the schedule of pension amounts (that is, the column totals for net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense).

.05 Exhibit 1 — Schedule of Employer Allocations

EXAMPLE COST-SHARING PENSION PLAN Schedule of Employer Allocations As of and for the year ended 6/30/20X5		
Employer	20X5 Actual Employer Contributions	Employer Allocation Percentage
Employer 1	$2,143,842	36.376
Employer 2	268,425	4.554
Employer 3	322,142	5.466
Employer 4	483,255	8.199
Employer 5	633,125	10.742
Employer 6	144,288	2.448
Employer 7	95,365	1.618
Employer 8	94,238	1.599
Employer 9	795,365	13.495
Employer 10	267,468	4.538
Employer 11	403,527	6.847
Employer 12	165,886	2.815
Employer 13	68,454	1.161
Employer 14	6,240	0.106
Employer 15	2,144	0.036
Total	$5,893,764	100.000

.06 Exhibit 2(a) — Schedule of Pension Amounts by Employer

EXAMPLE COST-SHARING PENSION PLAN
Schedule of Pension Amounts by Employer
As of and for the year ended 6/30/20X5

		Deferred Outflows of Resources					Deferred Inflows of Resources				Pension Expense		
Entity	Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of AssumptionsChanges of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Outflows of Resources	Differences Between Expected and Actual Experience	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Inflows of Resources	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts From Changes in Proportion and Differences Between Contributions and Proportionate Share of Contributions	Total Pension ExpenseTotal Pension Expense
Employer 1	$45,224,620	438,859	1,569,847	1,404,206	695,426	4,108,338	355,917	—	726,425	1,082,342	1,907,283	12,375	1,919,658
Employer 2	5,661,780	54,942	196,533	175,796	84,231	511,502	44,558	—	74,326	118,884	238,777	(1,793)	236,984
Employer 3	6,795,628	65,945	235,892	211,001	117,354	630,192	53,481	—	98,465	151,946	286,596	(8,088)	278,508
Employer 4	10,193,442	98,917	353,838	316,502	161,215	930,472	80,222	—	165,453	245,675	429,894	3,021	432,915
Employer 5	13,355,038	129,597	463,584	414,668	199,845	1,207,694	105,103	—	197,645	302,748	563,229	(9,900)	553,329
Employer 6	3,043,487	29,534	105,646	94,499	53,453	283,132	23,952	—	48,453	72,405	128,355	599	128,954
Employer 7	2,011,585	19,520	69,827	62,459	33,458	185,264	15,831	—	35,345	51,176	84,836	625	85,461
Employer 8	1,987,964	19,291	69,007	61,725	35,425	185,448	15,645	—	16,453	32,098	83,839	(5,712)	78,127
Employer 9	16,777,717	162,811	582,393	520,941	248,356	1,514,501	132,040	—	284,543	416,583	707,576	8,405	715,981
Employer 10	5,641,888	54,749	195,843	175,178	95,465	521,235	44,401	—	44,356	88,757	237,938	(1,188)	236,750
Employer 11	8,512,562	82,606	295,490	264,312	136,453	778,861	66,993	—	148,543	215,536	359,005	1,254	360,259
Employer 12	3,499,761	33,962	121,485	108,666	52,145	316,258	27,543	—	64,354	91,897	147,597	453	148,050
Employer 13	1,443,418	14,007	50,104	44,818	23,156	132,085	11,360	—	33,453	44,813	60,874	(205)	60,669

EXAMPLE COST-SHARING PENSION PLAN Schedule of Pension Amounts by Employer As of and for the year ended 6/30/20X5													
		Deferred Outflows of Resources					Deferred Inflows of Resources				Pension Expense		
Entity	Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of AssumptionsChanges of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Outflows of Resources	Differences Between Expected and Actual Experience	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions	Total Deferred Inflows of Resources	Proportionate Share of Plan Pension Expense	Net Amortization of Deferred Amounts From Changes in Proportion and Differences Between Contributions and Proportionate Share of Contributions	Total Pension ExpenseTotal Pension Expense
Employer 14	131,785	1,279	4,575	4,092	1,968	11,914	1,037	—	894	1,931	5,558	147	5,705
Employer 15	44,757	434	1,554	1,390	1,456	4,834	352	—	698	1,050	1,888	7	1,895
Total for All Entities	**$124,325,432**	**1,206,453**	**4,315,618**	**3,860,253**	**1,939,406**	**11,321,730**	**978,435**	**—**	**1,939,406**	**2,917,841**	**5,243,245**	**—**	**5,243,245**

.07 Exhibit 2(b) — Schedule of Collective Pension Amounts

EXAMPLE COST-SHARING PENSION PLAN Schedule of Collective Pension Amounts As of and for the year ended 6/30/20X5								
	Deferred Outflows of Resources				Deferred Inflows of Resources			
Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of Assumptions	Total Deferred Outflows of Resources Excluding Employer Specific Amounts*	Differences Between Expected and Actual Experience	Changes of Assumptions	Total Deferred Inflows of Resources Excluding Employer Specific Amounts*	Pension Expense*
$124,325,432	1,206,453	4,315,618	3,860,253	9,382,324	978,435	—	978,435	5,243,245

* Employer specific amounts that are excluded from this schedule are the changes in proportion and differences between employer contributions and proportionate share of contributions as well as the related amortization as defined in paragraphs 54–55 of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*.

[Issue Date: April 2014.]

2. Auditor of Governmental Agent Multiple-Employer Pension Plan

.08 *Question* — Management of a governmental agent multiple-employer pension plan (agent plan or plan) has calculated and prepared a schedule of changes in fiduciary net position by employer, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. If the plan auditor is engaged to perform an audit on a schedule such as that illustrated in exhibit 3, "Schedule of Changes in Fiduciary Net Position by Employer," of this interpretation, what type of audit report may be issued?

.09 *Interpretation* — Because the amounts contained in the previously mentioned schedule are considered specific elements, accounts, or items of the agent plan or participating employer's financial statements, the elements included in this schedule may be audited under section 805. An illustrative auditor's report on the schedule of changes in fiduciary net position by employer as a whole prepared pursuant to section 805 follows.

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Opinion[5]

We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer ("Schedule") of ABC Pension Plan, and the related notes.

In our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of ABC Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Schedule

Management is responsible for the preparation and fair presentation of the Schedule in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the

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[5] If the plan engages its auditor to opine on each employer column in the schedule of changes in fiduciary net position by employer as illustrated in exhibit 3, "Schedule of Changes in Fiduciary Net Position by Employer," of this interpretation, in addition to opining on the schedule as a whole, this section would be changed as follows:

> We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer (Schedule) of ABC Pension Plan, and the related notes. We have also audited the fiduciary net position of each individual employer as of June 30, 20X5, and the changes in fiduciary net position of each individual employer for the year then ended, included in the accompanying Schedule, and the related notes.
>
> In our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of each individual employer as of June 30, 20X5, and the changes in fiduciary net position of each individual employer for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Additionally, the "Supplementary Information" section would be eliminated.

preparation and fair presentation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the fiduciary net position and the changes in fiduciary net position included in the Schedule is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the Schedule.[6]

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the Schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the Schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Pension Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the Schedule.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Pension Plan's ability to continue as a going concern for a reasonable period of time.

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

Supplementary Information

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[6]The description of management's responsibilities relating to going concern required by paragraph .32*b* of section 700 may need to be included in this section of the report, or as stated in paragraph .A21 of section 805, may not be relevant or may need to be adapted as necessary. See paragraph .A21 of section 805.

Our audit of the financial statements of ABC Pension Plan was conducted for the purpose of forming an opinion on the financial statements as a whole. The individual employer information presented in each of the individual columns of the accompanying Schedule is presented for purposes of additional analysis and is not a required part of the financial statements. The individual employer information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Each column of individual employer information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the individual employer information presented in each individual column of the accompanying Schedule is stated fairly, in all material respects, in relation to the financial statements of ABC Pension Plan as a whole. We do not express an opinion on the fiduciary net position or changes in fiduciary net position of each individual employer.[7]

Other Matter

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of ABC Pension Plan as of and for the year ended June 30, 20X5, and our report thereon, dated October 15, 20X5, expressed an unmodified opinion on those financial statements.

Restriction on Use

Our report is intended solely for the information and use of ABC Pension Plan management, [*identify the body or individuals charged with governance of ABC Pension Plan*], ABC Pension Plan participating employers and their auditors and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

.10 *Question* — In planning and performing an audit of the schedule illustrated in exhibit 3 of this interpretation, may the plan auditor use the same materiality as used for the audit of the plan's basic financial statements?

.11 *Interpretation* — No. Section 805 states, in part:[8]

[7]In accordance with section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, if the auditor's report on the audited financial statements contains an opinion other than unmodified, the auditor should refer to the guidance in section 725.

[8]Paragraph .14 of section 805.

In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

As a frame of reference, the plan auditor considers judgments about matters that are material to users of the financial statements based on a consideration of the common financial information needs of users as a group. In the report described in paragraph .09 of this interpretation, the auditor is opining on two elements: fiduciary net position and the changes in fiduciary net position. Accordingly, the plan auditor should determine materiality separately for the two elements (that is, fiduciary net position and the changes in fiduciary net position). If the plan auditor has been engaged to opine on each employer column in the schedule, the auditor should determine materiality separately for each employer column.

.12 Exhibit 3 — Schedule of Changes in Fiduciary Net Position by Employer

EXAMPLE AGENT MULTIPLE-EMPLOYER PLAN Schedule of Changes in Fiduciary Net Position by Employer As of and for the year ended June 30, 20X5				
	Employer 1	Employer 2	Employer 3	Total
Additions:				
Contributions:				
Employer	86,252,000	34,500,000	51,751,000	172,503,000
Plan Member	32,662,000	13,065,000	19,597,000	65,324,000
Investment income:	80,965,000	20,347,000	37,112,000	138,424,000
Total additions	199,879,000	67,912,000	108,460,000	376,251,000
Deductions:				
Pension benefits, including refunds	384,635,000	184,352,000	228,356,000	797,343,000
Administrative expenses	4,716,000	1,886,000	2,829,000	9,431,000
Total deductions	389,351,000	186,238,000	231,185,000	806,774,000
Net increase (decrease)	(189,472,000)	(118,326,000)	(122,725,000)	(430,523,000)
Net position restricted for pension benefits:				
Beginning of year	5,843,645,000	1,468,538,000	2,678,595,000	9,990,778,000
End of year	$5,654,173,000	1,350,212,000	2,555,870,000	9,560,255,000

[Issue Date: June 2014.]

AU-C Section 806

Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements

Source: SAS No. 122; SAS No. 125.

Effective for reports on compliance issued in connection with audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility when the auditor is requested to report on an entity's compliance with aspects of contractual agreements or regulatory requirements, insofar as they relate to accounting matters, in connection with an audit of financial statements (referred to hereinafter as a report on compliance). Such a report is commonly referred to as a by-product report. (Ref: par. .A1–.A2)

.02 Entities may be required by contractual agreements, such as certain bond indentures and loan agreements, or regulatory agencies to provide an auditor's report on compliance. For example, loan agreements may impose a variety of obligations on borrowers involving matters such as payments into sinking funds, payments of interest, maintenance of current ratios, and restrictions of dividend payments. Loan agreements may also require the borrower to provide annual financial statements that have been audited. In some instances, the lenders or their trustees may request the auditor to report that the borrower has complied with certain covenants of the agreement relating to accounting matters. The auditor may satisfy this request by issuing a report on compliance in accordance with the requirements of this section.

.03 As described in paragraph .01, this section addresses reporting on an entity's compliance with aspects of contractual agreements or regulatory requirements in connection with an audit of financial statements. When the auditor is engaged or required by law or regulation to perform a compliance audit in accordance with generally accepted auditing standards (GAAS), the standards for financial audits under *Government Auditing Standards*, and a governmental audit requirement that requires the auditor to express an opinion on compliance with applicable compliance requirements, section 935, *Compliance Audits*, applies.

.04 When the auditor is engaged to perform a separate attest engagement on an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants, AT-C section 315, *Compliance Attestation*, applies to an examination of an entity's compliance and to an agreed-upon procedures engagement related to an entity's compliance. When the auditor is engaged to perform a separate attestation engagement related to an entity's internal control over compliance with requirements of specified laws, regulations, rules, contracts, or grants, AT-C section 205, *Examination Engagements*, applies to an examination of an entity's internal control over compliance and AT-C section 315 applies to agreed-upon procedures engagements related to an entity's internal control over compliance.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Effective Date

.05 This section is effective for reports on compliance issued in connection with audits of financial statements for periods ending on or after December 15, 2012.

Objective

.06 The objective of the auditor is to report appropriately on an entity's compliance with aspects of contractual agreements or regulatory requirements, in connection with the audit of financial statements, when the auditor is requested to report on such matters.

Requirements

Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements

.07 The auditor's report on compliance should include a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters, only when

a. the auditor has not identified any instances of noncompliance,

b. the auditor has expressed an unmodified or qualified opinion on the financial statements to which the applicable covenants of such contractual agreements or regulatory requirements relate, and

c. the applicable covenants or regulatory requirements relate to accounting matters that have been subjected to the audit procedures applied in the audit of financial statements.

.08 When the auditor has identified one or more instances of noncompliance, the report on compliance should describe such noncompliance (see paragraphs .12*f* and .13*b*).

.09 When the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should issue a report on compliance only when instances of noncompliance are identified. Therefore, the requirement in paragraph .08 also applies in such circumstances. The auditor should modify the wording of the report on compliance, as appropriate to the circumstances. (Ref: par. .A3)

.10 Notwithstanding the requirements in paragraphs .07–.09, the auditor is not precluded from issuing a report on compliance if such report is required by another set of auditing standards (for example, *Government Auditing Standards*), and the auditor has been engaged to audit the financial statements in accordance with both GAAS and those other standards.

.11 The report on compliance should be in writing and should be provided either in a separate report (see paragraph .12) or in one or more paragraphs included in the auditor's report on the financial statements (see paragraph .13).

Separate Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements

.12 When the auditor reports on compliance in a separate report, the report should include the following:

a. A title that includes the word *independent* to clearly indicate that it is the report of an independent auditor.

b. An appropriate addressee.

c. A paragraph that states that the financial statements were audited in accordance with generally accepted auditing standards and an identification of the United States of America as the country of origin of those standards (for example, auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards) and the date of the auditor's report on those financial statements.

d. If the auditor expressed a modified opinion[1] on the financial statements, a statement describing the nature of the modification. (Ref: par. .A4)

e. When no instances of noncompliance are identified by the auditor, a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement and a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters (see paragraphs .07 and .10).

f. When instances of noncompliance are identified by the auditor, a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters, and a description of the identified instances of noncompliance. (Ref: par. .A5)

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[1]See section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

g. A statement that the report is being provided in connection with the audit of the financial statements.

h. A statement that the audit was not directed primarily toward obtaining knowledge regarding compliance, and accordingly, had the auditor performed additional procedures, other matters may have come to the auditor's attention regarding noncompliance with the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters.

i. A paragraph that includes a description and the source of significant interpretations, if any, made by the entity's management relating to the provisions of the relevant contractual agreement or regulatory requirement.

j. A paragraph that includes an appropriate alert in accordance with the section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.[2] (Ref: par. .A6–.A7)

k. The manual or printed signature of the auditor's firm and the city and state where the auditor practices.

l. The date of the report, which should be the same date as the auditor's report on the financial statements.[3]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements Included in the Auditor's Report

.13 When a report on compliance is included in the auditor's report on the financial statements, the auditor's report should include an other-matter paragraph[4] that includes a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters, and also should include the following:

a. When no instances of noncompliance are identified by the auditor, a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters (see paragraphs .07 and .10).

b. When instances of noncompliance are identified by the auditor, a description of the identified instances of noncompliance. (Ref: par. .A5)

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[2]Paragraphs .06*c*, .07, and .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

[3]Paragraph .41 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

[4]See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, for guidance on other-matter paragraphs.

c. A statement that the communication is being provided in connection with the audit of the financial statements.

d. A statement that the audit was not directed primarily toward obtaining knowledge regarding compliance, and accordingly, had the auditor performed additional procedures, other matters may have come to the auditor's attention regarding noncompliance with the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters.

e. A paragraph that includes a description and the source of significant interpretations, if any, made by the entity's management relating to the provisions of the relevant contractual agreement or regulatory requirement.

f. A paragraph that includes an appropriate alert in accordance with section 905.[5] (Ref: par. .A6–.A7)

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The financial statements being audited and to which the applicable covenants of the contractual agreements or regulatory requirements relate may be either general purpose or special purpose financial statements.

Considerations Specific to Governmental Entities

.A2 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units and, therefore, requires the presentation of financial statements for its activities in various reporting units. Consequently, a reporting unit or aggregation of reporting units of the governmental entity represents an opinion unit to the auditor. In the context of this section, the auditor is responsible for reporting on compliance for each opinion unit within a governmental entity, when requested.

Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements (Ref: par. .09)

.A3 The exhibit, "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," provides an example of the wording of the report on compliance when the auditor has disclaimed an opinion on the financial statements.[6]

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[5]See footnote 2.

[6]Illustration 4, "A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial

Separate Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements (Ref: par. .12d)

.A4 The auditor may include certain additional communications in the separate report on compliance when the auditor included such additional communications in the auditor's report on the financial statements[7] that are not modifications to the auditor's opinion. For example, if the auditor included an emphasis-of-matter paragraph in the auditor's report on the financial statements because of an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time,[8] the auditor may also include this in the separate report on compliance.

Reporting When Instances of Noncompliance Are Identified (Ref: par. .12f and .13b)

.A5 When instances of noncompliance are identified, and the entity has obtained a waiver for such noncompliance, the auditor may include a statement in the report on compliance that a waiver has been obtained. The determination of whether to include such a statement is based on the procedures performed by the auditor to evaluate the waiver for the purposes of obtaining sufficient appropriate audit evidence in connection with the audit of the financial statements. All instances of noncompliance are required to be described in the report on compliance, in accordance with paragraph .08, including those for which a waiver has been obtained.

Restrictions on the Use of the Auditor's Report[9] (Ref: par. .12j and .13f)

.A6 An alert, as discussed in paragraphs .12*j* and .13*f*, is necessary because, although compliance matters may be identified by the auditor during the course of the audit engagement, the identification of such matters is not the primary objective of the audit engagement. In addition, the basis, assumptions, or purpose of the provisions in contractual agreements or regulatory requirements to which the report on compliance relates are developed for, and directed only to, the parties to the contractual agreement or the regulatory agency responsible for the requirements. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.A7 The alert that restricts the use of the report indicates that only the report on compliance with aspects of contractual agreements or regulatory requirements is restricted. Accordingly, the intended use of the auditor's report on the financial statements is not affected by this alert. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Statements," in the exhibit, "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements."

[7]See section 706.

[8]See section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

[9]See footnote 2.

Exhibit — Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements (Ref: par. .12–.13)

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Illustration 1 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When No Instances of Noncompliance Are Identified

Illustration 2 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified

Illustration 3 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and a Waiver Has Been Obtained

Illustration 4 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial Statements

Illustration 5 — A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified

Illustration 1 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When No Instances of Noncompliance Are Identified

Independent Auditor's Report

[*Appropriate Addressee*]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 16, 20X3.

In connection with our audit, nothing came to our attention that caused us to believe that XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Indenture dated July 21, 20X0, with ABC Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Indenture, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

Illustration 2 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified

Independent Auditor's Report

[*Appropriate Addressee*]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3.

In connection with our audit, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. Our audit was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

Illustration 3 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and a Waiver Has Been Obtained

Independent Auditor's Report

[*Appropriate Addressee*]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3.

In connection with our audit, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. The Company has received a waiver dated February 5, 20X3, from ABC Bank. Our audit was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

Illustration 4 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial Statements

Independent Auditor's Report

[*Appropriate Addressee*]

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3. Our report disclaims an opinion on such financial statements because of [*describe the scope limitation or matter causing the disclaimer*].

In connection with our engagement, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. Our engagement was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we been able to complete the audit, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

Illustration 5 — A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements[1]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

[1]The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[2]
- Evaluate appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Matter

In connection with our audit, nothing came to our attention that caused us to believe that ABC Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Indenture dated July 21, 20X0 with XYZ Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional

[2]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Indenture, insofar as they relate to accounting matters.

Restricted Use Relating to the Other Matter

The communication related to compliance with the aforementioned Indenture described in the Other Matter paragraph is intended solely for the information and use of the boards of directors and management of ABC Company and XYZ Bank and is not intended to be and should not be used by anyone other than these specified parties.[3]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Illustration added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Revised, February 2020, to reflect conforming changes necessary due to the issuance of SAS No. 134, as amended.]

[3]When the engagement is also performed in accordance with *Government Auditing Standards*, the alert may read as follows: "The purpose of the communication related to compliance with the aforementioned [*compliance requirements*] described in the Other Matter paragraph [*or, Report on Compliance*] is solely to describe the scope of our testing of compliance and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ABC Company's compliance. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide Government Auditing Standards *and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports.

AU-C Section 810

Engagements to Report on Summary Financial Statements

Source: SAS No. 122; SAS No. 137; SAS No. 139.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to an engagement to report separately on summary financial statements derived from financial statements audited in accordance with generally accepted auditing standards (GAAS) by the same auditor. In such an engagement, the auditor forms an opinion about whether the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria.

.02 This section does not apply to condensed financial statements or summarized financial information presented as comparative information.[1]Section 700, *Forming an Opinion and Reporting on Financial Statements*, addresses the auditor's responsibility for comparative information.[2] (Ref: par. .A1)

.03 Summary financial statements may be required by a designated accounting standards setter (for example, the Governmental Accounting Standards Board) to accompany the basic financial statements. This section does not apply in such circumstances. Section 730, *Required Supplementary Information*, addresses the auditor's responsibilities relating to information supplementary to the basic financial statements that is required by a designated accounting standards setter to accompany such financial statements.

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

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[1]Paragraph .11 of section 700, *Forming an Opinion and Reporting on Financial Statements*, defines the terms *condensed financial statements* and *comparative information*.

[2]Paragraphs .45–.52 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131.]

Objectives

.05 The objectives of the auditor are

a. to determine whether it is appropriate to accept the engagement to report on summary financial statements and,

b. if engaged to report on summary financial statements, to

   i. perform the procedures necessary as the basis for the auditor's opinion on the summary financial statements;

   ii. form an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria, based on an evaluation of the conclusions drawn from the evidence obtained; and

   iii. express clearly that opinion through a written report that also describes the basis for that opinion.

Definitions

.06 For purposes of this section, the following terms have the meanings attributed as follows:

Applied criteria. The criteria applied by management in the preparation of the summary financial statements.

Summary financial statements. Historical financial information[3] that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time. Summary financial statements are separately presented and are not presented as comparative information.

.07 In this section, the term *audited financial statements* refers to those financial statements[4] audited by the auditor in accordance with GAAS and from which the summary financial statements are derived.

Requirements

Engagement Acceptance

.08 The auditor should not accept an engagement to report on summary financial statements in accordance with this section unless the auditor has been engaged to conduct

[3]Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines the term *historical financial information*.

[4]Paragraph .14 of section 200 defines the term *financial statements*.

an audit in accordance with GAAS of the financial statements from which the summary financial statements are derived. (Ref: par. .A2)

.09 Before accepting an engagement to report on summary financial statements, the auditor should

a. determine whether the applied criteria are acceptable, including determining that the applied criteria (Ref: par. .A3–.A5)

   i. are free from bias so that the summary financial statements are not misleading.

   ii. permit reasonably consistent qualitative or quantitative measurements so that the information in the summary financial statements agrees with or can be recalculated from the related information in the audited financial statements.

   iii. are sufficiently complete so that the summary financial statements contain the information necessary and are at an appropriate level of aggregation, so that they are not misleading in the circumstances.

   iv. are relevant to the summary financial statements in view of their purpose.

b. obtain the agreement of management, in writing, that it acknowledges and understands its responsibility

   i. for the preparation of the summary financial statements in accordance with the applied criteria.

   ii. to clearly describe in the summary financial statements where the audited financial statements are available and to make the audited financial statements readily available to the intended users of the summary financial statements when the summary financial statements will not be accompanied by the audited financial statements. (Ref: par. .A6–.A7)

   iii. to provide the auditor with written representations, as described in paragraph .12.

   iv. to include the auditor's report on the summary financial statements in any document that contains the summary financial statements and indicates the auditor has reported on them.

c. obtain the agreement of management, in writing, about the expected form and content of the report on the summary financial statements, including the agreement that there may be circumstances in which the report may differ from its expected form and content. (Ref: par. .A8)

.10 If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management in accordance with paragraph .09*b*–*c*, the auditor should not accept the engagement to report on the summary financial statements. [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Nature of Procedures

.11 The auditor should perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

a. Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements. (Ref: par. .A9)

b. When the summary financial statements are not accompanied by the audited financial statements, evaluate

   i. whether the summary financial statements clearly describe where the audited financial statements are available and

   ii. whether the audited financial statements are readily available to the intended users of the summary financial statements. (Ref: par. .A7)

c. Evaluate whether the summary financial statements adequately disclose the applied criteria.

d. Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be recalculated from the related information in the audited financial statements.

e. Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.

f. Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so that they are not misleading in the circumstances.

Written Representations

.12 The auditor should request management to provide written representations, in the form of a representation letter addressed to the auditor, for the following matters:

a. Management has fulfilled its responsibility for the preparation of the summary financial statements in accordance with the applied criteria and believes the applied criteria are acceptable

b. Management has made the audited financial statements readily available to the intended users of the summary financial statements, when the summary financial statements will not be accompanied by the audited financial statements

c. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements,

i. whether any information has come to management's attention that would cause management to believe that any of the previous representations on the audited financial statements need to be modified

ii. whether any events have occurred subsequent to the date of the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements

.13 The date of the written representations should be as of the date of the auditor's report on the summary financial statements. The written representations should be for all summary financial statements and period(s) referred to in the auditor's report on the summary financial statements.

.14 When the auditor has concluded that an unmodified opinion on the summary financial statements is appropriate, the auditor's opinion should state that the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report (Ref: par. .A10)

.15 The auditor's report on summary financial statements should include the following elements:

a. A title that clearly indicates that it is the report of an independent auditor (Ref: par. .A11)

b. An addressee

c. Identification of the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements (Ref: par. .A12)

d. Identification of the audited financial statements from which the summary financial statements have been derived

e. Subject to paragraph .19, a clear expression of an opinion, as described in paragraphs .14 and .20

f. A statement indicating that the summary financial statements do not contain all the disclosures required by the [*financial reporting framework applied in the preparation of the financial statements*] and that reading the summary financial statements and the auditor's report thereon is not a substitute for reading the audited financial statements and the auditor's report thereon

g. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, a statement that the summary financial statements and the audited financial statements do not reflect the effects of events, if any, that occurred subsequent to the date of the auditor's report on the audited financial statements (see paragraph .17) (Ref: par. .A13)

h. Reference to the auditor's report on the audited financial statements, the date of that report, and, subject to paragraphs .19–.20, the fact that an unmodified opinion is expressed on the audited financial statements

i. A description of management's responsibility for the summary financial statements, explaining that management is responsible for the preparation of the summary financial statements in accordance with the applied criteria

j. A statement that the auditor is responsible for expressing an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on the procedures required by GAAS and an identification of the United States of America as the country of origin of those standards, including the following:

    i. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the applied criteria.

    ii. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the auditor did not perform any audit procedures regarding the audited financial statements after the date of the report on those financial statements.

k. The signature of the auditor's firm

l. The city and state where the auditor's report is issued

m. The date of the auditor's report

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.16 The auditor should date the auditor's report on the summary financial statements no earlier than

a. the date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary financial statements have been prepared and that management and, when appropriate, those charged with governance, have asserted that they have taken responsibility for them; and

b. the date of the auditor's report on the audited financial statements.

[Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.17 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements, the auditor may become aware of *subsequently discovered facts* as defined in section 560, *Subsequent Events and Subsequently Discovered Facts*. In such cases, the auditor should not release the auditor's report on the summary financial statements until the auditor's consideration of subsequently discovered facts in relation to the audited financial statements, in accordance with section 560, has been completed. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reference to the Auditor's Report on the Audited Financial Statements (Ref: par. .A14)

.18 If the auditor's report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, an other-matter paragraph, a going concern section, or communication of key audit matters, and the auditor expresses an unmodified opinion (see paragraph .14) on the summary financial statements, in addition to the elements in paragraph .15, the auditor's report on the summary financial statements should

a. state that the auditor's report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, an other-matter paragraph, a going concern section, or communication of key audit matters and

b. describe

   i. the basis for the qualified opinion on the audited financial statements and the effect thereof, if any, on the summary financial statements, or

   ii. the matter referred to in the emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the auditor's report on the audited financial statements and the effect thereof, if any, on the summary financial statements.

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.19 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor should withdraw from the engagement to report on the summary financial statements, when withdrawal is possible under applicable law or regulation. If it is not possible for the auditor to withdraw from the engagement, the auditor's report on the summary financial statements should, in addition to the elements in paragraph .15

a. state that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion.

b. describe the basis for that adverse opinion or disclaimer of opinion.

c. state that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express, and the auditor does not express, an opinion on the summary financial statements.

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Modified Opinion on the Summary Financial Statements

.20 If the summary financial statements are not consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor should express an adverse opinion on the summary financial statements. The auditor should state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section, the summary financial statements are not consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria. (Ref: par. .A18) [Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Restriction on Use or Alerting Readers to the Basis of Accounting

.21 When use of the auditor's report on the audited financial statements is restricted or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the auditor should include a similar restriction or alert in the auditor's report on the summary financial statements.

Comparatives

.22 If the audited financial statements contain comparative financial statements but the summary financial statements do not, the auditor should determine whether such omission is reasonable in the circumstances of the engagement. The auditor should determine the effect of an unreasonable omission on the auditor's report on the summary financial statements. (Ref: par. .A19–.A20)

.23 Unless the predecessor auditor's report on the prior period's summary financial statements is reissued with the summary financial statements, if the summary financial statements contain comparatives that were reported on by another auditor, the auditor's report on the summary financial statements should state

a. that the summary financial statements of the prior period were audited by a predecessor auditor.

b. the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore.

c. the date of that report.

.24 If the summary financial statements contain comparatives that were not reported on by the auditor or another auditor, the auditor's report on the summary financial statements should state that the comparative summary financial statements were not reported on by the auditor and, accordingly, the auditor does not express an opinion on the comparative summary financial statements.

Unaudited Information Presented With Summary Financial Statements (Ref: par. .A21)

.25 The auditor should evaluate whether any unaudited information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited information is not clearly differentiated from the summary financial statements, the auditor should ask management to change the presentation of the unaudited information. If management refuses to do so, the auditor should explain in the auditor's report on the summary financial statements that such information is not covered by that report and accordingly, the auditor does not express an opinion on the information.

Information in Documents Containing Summary Financial Statements (Ref: par. .A22)

.26 The auditor should read the information included in a document containing the summary financial statements and the auditor's report thereon and consider whether a material inconsistency exists between that information and the summary financial statements. [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.27 If, upon reading the other information, the auditor identifies that a material inconsistency appears to exist or becomes aware that the other information appears to be materially misstated, the auditor should discuss the matter with management and should consider appropriate further action in the circumstances. For an identified material inconsistency, the auditor should also determine whether the summary financial statements or the other information needs to be revised. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Auditor Association (Ref: par. .A23)

.28 If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor should request management to include the auditor's report in the document. If management does not do so, the auditor should determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document.

.29 The auditor may be engaged to report on the financial statements of an entity, while not engaged to report on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the financial statements audited by the auditor, the auditor should be satisfied that

a. the reference to the auditor is made in the context of the auditor's report on the audited financial statements, and

b. the statement does not give the impression that the auditor has reported on the summary financial statements.

If either *a* or *b* is not met, the auditor should request management to change the statement to meet both of the criteria in *a* and *b*, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor should advise management that the auditor disagrees with the reference to the auditor, and the auditor should determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 Financial statements may present comparative information in the form of condensed financial statements or summarized financial information. For example, entities such as state and local governmental units may present prior period financial information in their government-wide financial statements only for the total reporting entity rather than disaggregated by governmental activities, business-type activities, total primary government, and discretely presented component units. Also, not-for-profit organizations frequently present certain information for the prior period in total rather than by net asset class. As described in paragraph .02, this section does not apply to reporting on financial statements containing such comparative information. Summary financial statements differ from comparative information. Summary financial statements may be presented in a document containing financial statements or in a separate document, whereas comparative information is presented within the financial statements.[5] [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Engagement Acceptance

.A2 The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities regarding the summary financial statements, in accordance with this section. Application of this section will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor also has not audited the financial statements from which the summary financial statements are derived. (Ref: par. .08)

[5][Footnote deleted by the issuance of SAS No. 139, March 2020.]

Criteria (Ref: par. .09a)

.A3 The preparation of summary financial statements requires management to determine the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so that they are not misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.

.A4 Factors that may affect the auditor's determination of the acceptability of the applied criteria include the following:

- The nature of the entity
- The purpose of the summary financial statements
- The information needs of the intended users of the summary financial statements
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances

.A5 The criteria for the preparation of summary financial statements may be established by an authorized or recognized standards-setting organization or by law or regulation. In many such cases, the auditor may presume that such criteria are acceptable. When established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry.

Availability of the Audited Financial Statements (Ref: par. .09b(ii) and .11b(ii))

.A6 Summary financial statements are presented in considerably less detail than the complete set of financial statements and do not contain all the disclosures required by the financial reporting framework applied in the preparation of the complete set of financial statements. In addition, reading the summary financial statements is not a substitute for reading the audited financial statements. Accordingly, before accepting an engagement to report on summary financial statements, the auditor is required by paragraph .09*b*(ii) to obtain management's agreement that it acknowledges and understands its responsibility to make the audited financial statements readily available to the intended users of the summary financial statements, when the summary financial statements will not be accompanied by the audited financial statements.

.A7 Audited financial statements are deemed to be readily available if a third-party user can obtain the audited financial statements without any further action by the entity (for example, financial statements on an entity's website may be considered readily available but being available upon request is not considered readily available).

Agreement on the Expected Form and Content of the Report (Ref: par. .09c)

.A8 Agreement with management about the expected form and content of the report on the summary financial statements may include a description of the types of opinions the auditor may express. It is not necessary to describe the type of opinion expected to be issued. The auditor also may indicate that circumstances may arise in which it is necessary for the auditor to withdraw from the engagement.

Nature of Procedures (Ref: par. .11)

.A9 Adequate disclosure of the summarized nature of summary financial statements and the identity of the audited financial statements, as referred to in paragraph .11*a*, may, for example, be provided by a title such as "Summary Financial Statements Prepared From the Audited Financial Statements as of and for the Year Ended December 31, 20X1."

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report (Ref: par. .15)

.A10 An auditor who is engaged to report on summary financial statements does not report in the same manner as the auditor reported on the complete set of financial statements from which they are derived. To do so might lead users to assume, erroneously, that the summary financial statements include all the disclosures necessary for the complete set of financial statements. For the same reason, summary financial statements need to adequately disclose their summarized nature, as referred to in paragraphs .11*a* and .A9. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Title (Ref: par. .15a)

.A11 A title that includes the word *independent* to clearly indicate the report is the report of an independent auditor (for example, *Report of the Independent Auditor*) affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Identification of the Summary Financial Statements (Ref: par. .15c)

.A12 When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers identify the summary financial statements that relate to the auditor's report. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Date of the Auditor's Report on the Summary Financial Statements and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements (Ref: par. .15c(iv))

.A13 The auditor's report on the summary financial statements may be dated as of the same date or later than the date of the auditor's report on the audited financial statements, depending on when the procedures in paragraph .11 are performed and, as required by paragraph .16, when the auditor has obtained sufficient appropriate evidence on which to base the opinion. When the auditor reports on the summary financial statements after the completion of the financial statement audit, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements because the summary financial statements are derived from the audited financial statements and do not update them. In such cases, however, paragraph .15*c*(iv) requires the auditor's report to state that the summary financial statements and the audited financial statements do not reflect the effects of events, if any, that occurred subsequent to the date of the auditor's report on the audited financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reference to the Auditor's Report on the Audited Financial Statements (Ref: par. .18)

.A14 If the auditor's report on the audited financial statements contains a qualified opinion, the auditor may determine that, due to the effect on the summary financial statements, it is inappropriate to express an opinion on the summary financial statements. In such circumstances, the auditor may adapt and apply the requirement in paragraph .19. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A15 Paragraph .18*a* requires the auditor to include a statement in the auditor's report on the summary financial statements when the auditor's report on the audited financial statements includes communication of one or more key audit matters in accordance with section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. However, the auditor is not required to describe the individual key audit matters in the auditor's report on the summary financial statements. [Paragraph added, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.A16 The statements and descriptions required by paragraph .18 are intended to draw attention to those matters and are not a substitute for reading the auditor's report on the audited financial statements. The required descriptions are intended to convey the nature of the matters and need not repeat the corresponding text in the auditor's report on the audited financial statements in its entirety. [Paragraph added, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.A17 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, paragraph .19 requires the auditor to withdraw from the engagement to report on the summary financial statements, when withdrawal is possible under applicable law or regulation. When an entity is required by law or regulation to provide a report on summary financial statements, the auditor is neither precluded from withdrawing, nor required to withdraw, from the engagement. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Modified Opinion on the Summary Financial Statements (Ref: par. .20)

.A18 If the summary financial statements are not consistent, in all material respects, with the audited financial statements in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor is required by paragraph .20 to express an adverse opinion on the summary financial statements. Due to the summarized nature of the summary financial statements, a qualified opinion would not be appropriate; the summary financial statements either are or are not consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Comparatives (Ref: par. .22)

.A19 If the audited financial statements contain comparative financial statements, a presumption exists that the summary financial statements also would contain comparatives. Section 700 addresses the auditor's responsibilities regarding comparative financial statements in an audit of financial statements.[6] [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A20 Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include:

- The nature and objective of the summary financial statements
- The applied criteria
- The information needs of the intended users of the summary financial statements

[Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Unaudited Information Presented With Summary Financial Statements (Ref: par. .25)

.A21 Section 700 contains a requirement and guidance related to information presented in the financial statements that is not required by the applicable financial reporting framework.[7] Such requirement and guidance, adapted as necessary in the circumstances, may be helpful in applying the requirement in paragraph .25. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Other Information in Documents Containing Summary Financial Statements (Ref: par. .26–.27)

.A22 Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, contains requirements and guidance relating to reading other information included in an entity's annual report and responding when a material inconsistency appears to exist or other information appears to be materially misstated. Adapted as necessary in the circumstances, these requirements and related guidance may be helpful in applying the requirements in paragraphs .26–.27. [As amended, effective for audits of financial

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[6] Paragraphs .45–.52 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

[7] Paragraph .59 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

statements for periods ending on or after December 15, 2021, by SAS No. 137. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Auditor Association (Ref: par. .28–.29)

.A23 Other appropriate actions the auditor may take when management does not take the requested action may include informing the intended users and other known third-party users of the inappropriate reference to the auditor, including that the auditor did not report, and does not express an opinion on, the summary financial statements. The auditor's course of action depends on the auditor's association with misleading information and the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Exhibit — Illustrations of Reports on Summary Financial Statements

.A24

Illustration 1 — An Unmodified Opinion Is Expressed on the Summary Financial Statements (the Auditor's Report on the Summary Financial Statements Is Dated Later Than the Date of the Auditor's Report on the Financial Statements From Which the Summary Financial Statements Are Derived)

Illustration 2 — An Unmodified Opinion Is Expressed on the Summary Financial Statements and a Qualified Opinion Is Expressed on the Audited Financial Statements

Illustration 3 — An Adverse Opinion Is Expressed on the Audited Financial Statements (as a Result of the Adverse Opinion on the Audited Financial Statements, It Is Inappropriate to Express, and the Auditor Does Not Express, an Opinion on the Summary Financial Statements)

Illustration 4 — An Adverse Opinion Is Expressed on the Summary Financial Statements Because They Are Not Consistent, in All Material Respects, With the Audited Financial Statements, in Accordance With the Applied Criteria

Illustration 1 — An Unmodified Opinion Is Expressed on the Summary Financial Statements (the Auditor's Report on the Summary Financial Statements Is Dated Later Than the Date of the Auditor's Report on the Financial Statements From Which the Summary Financial Statements Are Derived)

Circumstances include all of the following:

- An unmodified opinion is expressed on the audited financial statements.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- An unmodified opinion is expressed on the summary financial statements.
- The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.[1,2]

Independent Auditor's Report on Summary Financial Statements

[*Appropriate Addressee*]

Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those audited financial statements in our report dated February 15, 20X2.

In our opinion, the accompanying summary financial statements of ABC Company as of and for the year ended December 31, 20X1 referred to above are consistent, in all material respects, with the audited financial statements from which they have been derived, on the basis described in Note X.

Summary Financial Statements

[1]If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the following statement is added to the Summary Financial Statements section of the report: "The audited financial statements, and the summary financial statements derived therefrom, do not reflect the effects of events, if any, that occurred subsequent to the date of our report on the audited financial statements." [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

[2]If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the following statement is added to the Auditor's Responsibility section of the report: "We did not perform any audit procedures regarding the audited financial statements after the date of the report on those financial statements." [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

The summary financial statements do not contain all the disclosures required by [*describe financial reporting framework applied in the preparation of the financial statements of ABC Company*]. Reading the summary financial statements and the auditor's report hereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon. The summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of our report on the audited financial statements.

Responsibility of Management for the Summary Financial Statements

Management is responsible for the preparation of the financial statements in accordance with the criteria described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X. We did not perform any audit procedures regarding the audited financial statements after the date of our report on those financial statements.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — An Unmodified Opinion Is Expressed on the Summary Financial Statements and a Qualified Opinion Is Expressed on the Audited Financial Statements

Circumstances include all of the following:

- A qualified opinion is expressed on the audited financial statements.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- An unmodified opinion is expressed on the summary financial statements.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[*Appropriate Addressee*]

Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed a qualified audit opinion on those audited financial statements in our report dated February 15, 20X2 (see below).

In our opinion, the accompanying summary financial statements of ABC Company as of and for the year ended December 31, 20X1, referred to above are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the criteria described in Note X.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by [*describe financial reporting framework applied in the preparation of the financial statements of ABC Company*]. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

The Audited Financial Statements and Our Report Thereon

The basis for our qualified audit opinion was that management has not stated the inventories at the lower of cost or net realizable value but has stated them solely at cost, which constitutes a departure from [*describe financial reporting framework applied in the* *preparation of the financial statements of ABC Company*]. The Company's records indicate that, had management stated the inventories at the lower of cost or net realizable value, an amount of $XXX would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by $XXX, and income tax, net income, and stockholders' equity would have been reduced by $XXX, $XXX, and $XXX, respectively.

Responsibilities of Management for the Summary Financial Statements

Management is responsible for the preparation of the summary financial statements in accordance with the criteria described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — An Adverse Opinion Is Expressed on the Audited Financial Statements (as a Result of the Adverse Opinion on the Audited Financial Statements, It Is Inappropriate to Express, and the Auditor Does Not Express, an Opinion on the Summary Financial Statements)

Circumstances include both of the following:

- An adverse opinion is expressed on the audited financial statements. As a result of the adverse opinion on the audited financial statements, it is inappropriate to express, and the auditor does not express, an opinion on the summary financial statements, as described in paragraph .19.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[*Appropriate Addressee*]

Disclaimer of Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1.

As a result of the adverse opinion on the audited financial statements discussed in the Audited Financial Statements and Our Report Thereon section of our report, it is inappropriate to express, and we do not express, an opinion on the accompanying summary financial statements.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by [*describe financial reporting framework applied in the preparation of the audited financial statements of ABC Company*]. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

The Audited Financial Statements and Our Report Thereon

In our report dated February 15, 20X2, we expressed an adverse audit opinion on the financial statements of ABC Company as of and for the year ended December 31, 20X1.

The basis for our adverse audit opinion was [*describe basis for adverse audit opinion*]. Our adverse audit opinion stated that [*describe adverse audit opinion*].

Responsibility of Management for the Summary Financial Statements

Management is responsible for the preparation of these summary financial statements on the basis described in Note X.

Auditor's Responsibility

We were engaged to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. However, as a result of the adverse opinion on the audited financial statements as discussed above, we do not express an opinion on the accompanying summary financial statements.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 4 — An Adverse Opinion Is Expressed on the Summary Financial Statements Because They Are Not Consistent, in All Material Respects, With the Audited Financial Statements, in Accordance With the Applied Criteria

Circumstances include all of the following:

- An unmodified opinion is expressed on the audited financial statements.
- Established criteria for the preparation of summary financial statements exist.
- The auditor expresses an adverse opinion on the summary financial statements because they are not consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[*Appropriate Addressee*]

Adverse Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those audited financial statements in our report dated February 15, 20X2.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section, the summary financial statements of ABC Company as of and for the year ended December 31, 20X1 referred to above are not consistent with the audited financial statements from which they have been derived, on the basis described in Note X.

Basis for Adverse Opinion

[*Describe matter that caused the summary financial statements not to be consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria*.]

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by [*describe financial reporting framework applied in the preparation of the financial statements of ABC Company*]. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

Responsibilities of Management for the Summary Financial Statements

Management is responsible for the preparation of the summary financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion about whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

AU-C Sections 900–999

SPECIAL CONSIDERATIONS IN THE UNITED STATES

AU-C Section 905

Alert That Restricts the Use of the Auditor's Written Communication

Source: SAS No. 125; SAS 130.

Effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012. For all other engagements conducted in accordance with GAAS, this section is effective for the auditor's written communications issued on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility, when required or the auditor decides, to include in the auditor's report or other written communication issued by the auditor in connection with an engagement conducted in accordance with generally accepted auditing standards (GAAS) (hereinafter referred to in this section as auditor's written communication) language that restricts the use of the auditor's written communication. This language is referred to in this section as an alert. In an auditor's report, such language is included in an other-matter paragraph. (Ref: par. .A1 and .A3)

.02 Appendix A, "List of AU-C Sections Relating to the Restricted Use of the Auditor's Written Communication," identifies sections that contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. Accordingly, the requirements in this section regarding the form of such alert apply. (Ref: par. .A2)

Effective Date

.03 This section is effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012. For all other engagements conducted in accordance with GAAS, this section is effective for the auditor's written communications issued on or after December 15, 2012.

Objective

.04 The objective of the auditor is to restrict the use of the auditor's written communication by including an alert when the potential exists for the auditor's written communication to be misunderstood if taken out of the context in which the auditor's written communication is intended to be used.

Definition

.05 For purposes of GAAS, the following term has the meaning attributed as follows:

Specified parties. The intended users of the auditor's written communication.

Requirements

Alert That Restricts the Use of the Auditor's Written Communication

.06 The auditor's written communication should include an alert, in a separate paragraph, that restricts its use when the subject matter of the auditor's written communication is based on (Ref: par. .A2–.A3)

a. measurement or disclosure criteria that are determined by the auditor to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria,

b. measurement or disclosure criteria that are available only to the specified parties, or

c. matters identified by the auditor during the course of the audit engagement when the identification of such matters is not the primary objective of the audit engagement (commonly referred to as a by-product report). (Ref: par. .A4–.A7)

.07 Unless specified otherwise by this section or other relevant sections, the alert that restricts the use of the auditor's written communication required by paragraph .06 should

a. state that the auditor's written communication is intended solely for the information and use of the specified parties.

b. identify the specified parties for whom use is intended. In situations covered by paragraph .06*c*, the specified parties should only include management, those charged with governance, others within the entity, the parties to the contract or agreement, or the regulatory agencies to whose jurisdiction the entity is subject, as appropriate in the circumstances.

c. state that the auditor's written communication is not intended to be and should not be used by anyone other than the specified parties. (Ref: par. .A8–.A9)

Adding Other Specified Parties (Ref: par. .A10)

.08 When, in accordance with paragraph .06, the auditor includes an alert that restricts the use of the auditor's written communication to certain specified parties, and the auditor is requested to add other parties as specified parties, the auditor should determine whether to agree to add the other parties as specified parties. In situations covered by paragraph .06*c*, the auditor should not agree to add as specified parties any other parties not described in paragraph .07*b*.

.09 When the auditor agrees to add other parties as specified parties, the auditor should obtain affirmative acknowledgment, in writing, from the other parties of their understanding of

a. the nature of the engagement resulting in the auditor's written communication,

b. the measurement or disclosure criteria related to the subject matter of the auditor's written communication, and

c. the auditor's written communication.

.10 If the other parties are added after the release of the auditor's written communication, in addition to the requirements of paragraph .09, the auditor should take one of the following actions:

a. Amend the auditor's written communication to add the other parties. In such circumstances, the auditor should not change the original date of the auditor's written communication.

b. Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties. The auditor should state in the acknowledgment that no procedures were performed subsequent to the original date of the auditor's written communication or the date that the engagement was completed, as appropriate.

Alert for Engagements Performed in Accordance With *Government Auditing Standards* (Ref: par. .A11)

.11 The alert language required by paragraph .07 should not be used when

a. the engagement is performed in accordance with *Government Auditing Standards*, and

b. the auditor's written communication pursuant to that engagement is issued in accordance with

   i. section 265, *Communicating Internal Control Related Matters Identified in an Audit*;

   ii. section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*;

   iii. section 935, *Compliance Audits*; or

   iv. section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*.

Instead, the alert required by paragraph .06 should

a. describe the purpose of the auditor's written communication and

b. state that the auditor's written communication is not suitable for any other purpose.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Application and Other Explanatory Material

Alert That Restricts the Use of the Auditor's Written Communication (Ref: par. .01–.02 and .06)

.A1 In addition to auditor's reports, auditor's written communications may include letters or presentation materials (for example, letters communicating internal control related matters or presentations addressing communications with those charged with governance).

.A2 Certain sections, identified in appendix A, contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. The need for an alert that restricts the use of the auditor's written communication arises from the potential for the auditor's written communication to be misunderstood if taken out of the context in which the auditor's written communication is intended to be used. The context in which the auditor's written communication is intended to be used may consist of a number of circumstances, including

- the purpose of the auditor's written communication;
- the nature of the procedures applied in its preparation;
- the basis of, or assumptions used in, its preparation; and
- the extent to which the procedures performed generally are known or understood.

.A3 Auditor's reports on financial statements prepared in accordance with a general purpose framework ordinarily do not include an alert that restricts their use. However, nothing in GAAS precludes an auditor from including such an alert in any auditor's report or other auditor's written communication. For example, financial statements prepared specifically for use in connection with an acquisition may be prepared in accordance with a general purpose framework because the parties involved in the transaction have agreed that such general purpose financial statements are appropriate for their purposes. Nevertheless, when the terms of the engagement to audit those financial statements require the auditor to supply the auditor's report only to specified parties, the auditor may consider it necessary in the circumstances to include an other-matter paragraph in the auditor's report that restricts the use of the auditor's report.[1]

.A4 The subject matter of the auditor's written communication may be based on matters identified by the auditor during the course of the audit engagement when identification of such matters is not the primary objective of the audit engagement (commonly referred to

[1]Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* .

as a by-product report) (for example, communication about internal control or compliance related matters identified in an audit of financial statements, the primary objective of which is to express an opinion on the financial statements). Because such communication can only be understood in relation to the primary objective of the audit engagement, it may be misinterpreted or misunderstood. Accordingly, paragraph .06*c* requires such auditor's written communication to include an alert that restricts its use.

Alert That Restricts the Use of the Auditor's Written Communication Included in General Use Communications

.A5 An auditor's written communication that is required by paragraph .06 to include an alert that restricts its use may be included in a document that also contains an auditor's written communication that is for general use. In such circumstances, the use of the general use communication is not affected.

.A6 An auditor may also issue a single combined auditor's written communication that includes (*a*) communications that are required by paragraph .06 to include an alert that restricts their use and (*b*) communications that are for general use. If these two types of communications are clearly differentiated within the combined communication, such as through the use of appropriate headers, the alert that restricts the use of the auditor's written communication may be limited to the communications required by paragraph .06 to include such an alert. In such circumstances, the use of the general use communication is not affected. An example of a single combined auditor's written communication addressing a matter that was not the primary objective of the audit engagement that is included in a general use communication is provided in the exhibit "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," of section 806.[2]

Distribution of the Auditor's Written Communication

.A7 An auditor is not responsible for controlling, and cannot control, distribution of the auditor's written communication after its release. The alert that restricts the use of the auditor's written communication is designed to avoid misunderstandings related to the use of the auditor's written communication, particularly if the auditor's written communication is taken out of the context in which the auditor's written communication is intended to be used. An auditor may consider informing the entity or other specified parties that the auditor's written communication is not intended for distribution to parties other than those specified in the auditor's written communication. The auditor may, in connection with establishing the terms of the engagement, reach an understanding with the entity that the intended use of the auditor's written communication will be restricted and may obtain the entity's agreement that the entity and specified parties will not distribute such auditor's written communication to parties other than those identified therein.

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[2]Illustration 5, "Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified," in the exhibit "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements* .

Illustrative Alert Language (Ref: par. .07)

.A8 The alert that restricts the use of the auditor's written communication may list the specified parties or refer to the specified parties listed elsewhere in the auditor's written communication. The following illustrates language that includes the elements required by paragraph .07:

> This [*report, letter, presentation, or communication*] is intended solely for the information and use of [*list or refer to the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

.A9 Other sections, such as section 920, *Letters for Underwriters and Certain Other Requesting Parties*, may include specific requirements relating to the matters to be included in the alert that restrict the use of the auditor's written communication, as required by paragraph .06, including identifying the specified parties.

Adding Other Specified Parties (Ref: par. .08–.10)

.A10 When the auditor is requested to add other parties as specified parties, the auditor may agree to add the other parties as specified parties based on the auditor's consideration of factors such as the identity of the other parties and the intended use of the auditor's written communication.

Alert for Engagements Performed in Accordance With Government Auditing Standards (Ref: par. .11)

.A11 *Government Auditing Standards* regard the auditor's written communications issued pursuant to the sections, identified in paragraph .11, to be an integral part of the audit engagement for the purpose of assessing the results of the engagement. Accordingly, different alert language is used. The following illustrates language that includes the elements of the alert required by paragraph .11:

> The purpose of this [*report, letter, presentation, or communication*] is solely to [*describe the purpose of the auditor's written communication, such as to describe the scope of our testing of internal control over financial reporting and compliance, and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over financial reporting or on compliance*]. This [*report, letter, presentation, or communication*] is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering [*describe the results that are being assessed, such as the entity's internal control over financial reporting and compliance*]. Accordingly, this [*report, letter, presentation, or communication*] is not suitable for any other purpose.

Appendix A — List of AU-C Sections Relating to the Restricted Use of the Auditor's Written Communication

.A12

This appendix identifies paragraphs in other sections that contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. The list is not a substitute for considering the requirements and related application and other explanatory material in the other sections.

- Paragraph .17 of section 260, *The Auditor's Communication With Those Charged With Governance*
- Paragraphs .14*d*, .A32, and .A38–.A39 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- Paragraph .A16 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Paragraphs .20, .A26–.A27, and .A33 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
- Paragraphs .12–.13 and .A6–.A8 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- Paragraphs .14*f* and .A6 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*
- Paragraphs .33 and .A34 of section 920, *Letters for Underwriters and Certain Other Requesting Parties*
- Paragraphs .30, .31*i*, and .A33 of section 935, *Compliance Audits*

AU-C Section 910

Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

Source: SAS No. 124; SAS No. 134; SAS No. 138; SAS No. 140.

Effective for audits of financial statements for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses circumstances in which an auditor practicing in the United States is engaged to report on financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to establish generally accepted accounting principles (GAAP) (hereinafter referred to as a financial reporting framework generally accepted in another country) when such audited financial statements are intended for use outside the United States. This section is not intended to preclude the use of such audited financial statements in the United States.

.02 Pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001), the Council designates the bodies to establish GAAP. This section does not apply to financial statements prepared in accordance with financial reporting frameworks established by the bodies designated by the Council. Section 700, *Forming an Opinion and Reporting on Financial Statements*, applies to engagements to report on such financial statements, including financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.03 This section is applicable to engagements to report on financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement in an appropriate note to the financial statements that its financial statements are in compliance with IFRS as promulgated by the IASB.

.04 This section does not apply to engagements to report on financial statements of a U.S. subsidiary of a foreign registrant parent company that are presented in the parent company's filing with the U.S. Securities and Exchange Commission when the subsidiary's financial statements have been prepared in accordance with a financial reporting framework used by the parent company and audited in accordance with auditing standards generally accepted in the United States of America (GAAS).

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.06 The objective of the auditor, when engaged to report on financial statements prepared in accordance with a financial reporting framework generally accepted in another country, when such audited financial statements are intended for use outside the United States, is to address appropriately the special considerations that are relevant to

a. the acceptance of the engagement,

b. the planning and performance of the engagement, and

c. forming an opinion and reporting on the financial statements.

Requirements

Considerations When Accepting the Engagement (Ref: par. .A1)

.07 Section 210A, *Terms of Engagement,* requires the auditor, as part of establishing whether the preconditions for an audit are present prior to accepting the engagement, to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.[1] In an audit of financial statements prepared in accordance with a financial reporting framework generally accepted in another country, the auditor should obtain an understanding of

a. The purpose for which the financial statements are prepared and whether the financial reporting framework applied in the preparation of the financial statements is a fair presentation framework.

b. The intended users of the financial statements.

c. The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

.08 When the auditor plans to use the form and content of the auditor's report of another country, the auditor should obtain an understanding of the applicable legal responsibilities involved. (Ref: par. .A8)

[1]See paragraph .06 of section 210A, *Terms of Engagement*.

Performance (Ref: par. .A2–.A3)

.09 When auditing financial statements prepared in accordance with a financial reporting framework generally accepted in another country that are intended for use only outside the United States, the auditor should comply with GAAS, except for requirements related to the form and content of the report in the situation described in paragraph .12. The auditor should determine whether the application of GAAS requires special consideration in the circumstances of the engagement.

.10 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements,* requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.[2] When reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country, the auditor should obtain an understanding of such framework.

Application of Auditing Standards of Another Country

.11 If the auditor is engaged to audit financial statements prepared in accordance with a financial reporting framework generally accepted in another country, and the agreed-upon terms of engagement require the auditor to apply either the auditing standards of that country or International Standards on Auditing (ISAs), the auditor should obtain an understanding of and apply those relevant auditing standards, as well as GAAS, except for requirements related to the form and content of the report in the situation described in paragraph .12. (Ref: par. .A4–.A6)

Reporting

Reporting—Use Only Outside the United States

.12 If the auditor is reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country that are intended for use only outside the United States, the auditor should report using either

a. a U.S. form of report that reflects that the financial statements being reported on have been prepared in accordance with a financial reporting framework generally accepted in another country, including (Ref: par. .A7)

   i. the elements required by section 700 and

   ii. a statement that refers to the note to the financial statements that describes the basis of presentation of the financial statements on which the auditor is reporting, including identification of the country of origin of the accounting principles, or

b. the report form and content of the other country (or, if applicable, as set forth in the ISAs), provided that

[2]See paragraph .12*c* of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

i. such a report would be issued by auditors in the other country in similar circumstances,

ii. the auditor understands and has obtained sufficient appropriate audit evidence to support the statements contained in such a report, and

iii. the auditor has complied with the reporting standards of that country and identifies the other country in the report. (Ref: par. .A8–.A9)

Reporting—Use in the United States

.13 If financial statements prepared in accordance with a financial reporting framework generally accepted in another country also are intended for use in the United States, the auditor should report using the U.S. form of report.[3] In addition, the auditor should include in the auditor's report an emphasis-of-matter paragraph[4] that

a. identifies the financial reporting framework used in the preparation of the financial statements,

b. refers to the note to the financial statements that describes that framework, and

c. indicates that such framework differs from accounting principles generally accepted in the United States of America. (Ref: par. .A7 and .A10)

Application and Other Explanatory Material

Considerations When Accepting the Engagement (Ref: par. .07–.08)

.A1 In obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users, the auditor may consider whether the intended users are likely to be familiar with the applicable financial reporting framework. For example, if the financial statements are to be used in the United States in addition to the other country(ies) for which they are intended, the auditor may consider whether intended users within the United States deal directly with the entity and whether the financial statements are to be used in a manner that permits such users to discuss with the entity differences from accounting and reporting practices in the United States and their significance. Accordingly, an auditor may conclude that financial statements prepared in accordance with a financial reporting framework generally accepted in another country are not appropriate for use in a private placement memorandum to be distributed widely in the United States.

Performance (Ref: par. .09–.10)

.A2 The accounting principles used to prepare financial statements in accordance with a financial reporting framework generally accepted in another country may differ from those

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[3]See section 700, *Forming an Opinion and Reporting on Financial Statements*.

[4]See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

used to prepare financial statements in accordance with accounting principles generally accepted in the United States of America, and such differences may affect the auditor's risk assessment and design of further audit procedures. For example, the financial reporting framework generally accepted in another country may require that certain assets be revalued to adjust for the effects of inflation—in which case, the auditor may find it necessary to perform procedures to test the revaluation adjustments. As another example, a particular country's financial reporting framework may not require or permit recognition of deferred taxes; consequently, procedures for testing deferred tax balances would not be applicable.

.A3 An understanding of the financial reporting framework generally accepted in another country may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe the financial reporting framework generally accepted in the other country. Often, the application of accounting principles to a particular situation requires practical experience, and accordingly, the auditor may consult with persons having expertise in applying the financial reporting framework of the other country.

Application of Auditing Standards of Another Country (Ref: par. .11)

.A4 Applying either the auditing standards of another country or the ISAs may require the auditor to perform procedures in addition to those procedures required by GAAS.

.A5 An understanding of the auditing standards of another country or the ISAs may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe such standards.

.A6 Statutes or professional literature, or codifications thereof, however, may not include a complete description of the auditing practices in another country. The auditor may consult with persons having expertise in, including practical experience in applying, the auditing standards of the other country or the ISAs, as relevant.

Reporting (Ref: par. .08 and .12–.13)

.A7 The exhibit "Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country" contains illustrations of auditor's reports on financial statements incorporating the elements required by paragraphs .12–.13.

Reporting—Use Only Outside the United States (Ref: par. .08 and .12)

.A8 Even when the form and content of the auditor's report used in another country appears similar to that used in the United States, the report may convey a different meaning and entail different legal responsibilities for the auditor due to custom or culture. Issuing a report of another country may require the auditor to report on statutory compliance or otherwise require understanding of local laws and regulations. When issuing the auditor's report of another country, the auditor is required by paragraph .08 to obtain an understanding of applicable legal responsibilities, in addition to the auditing standards and the financial reporting framework generally accepted in the other country, as required by paragraphs .07 and .10–.11. Accordingly, depending on the nature and extent of the auditor's knowledge and experience, the auditor may consult with persons having expertise in the audit reporting practices of the other country and associated legal responsibilities to obtain the understanding needed to issue that country's report.

.A9 An entity that prepares financial statements in accordance with GAAP also may prepare financial statements in accordance with a financial reporting framework generally accepted in another country for use outside the United States (for example, financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRS as issued by the IASB). In such circumstances, the auditor may report on the financial statements that are in accordance with a financial reporting framework generally accepted in another country by reporting in accordance with paragraph .12. The auditor may include in one or both of the reports a statement that another report has been issued on the financial statements for the entity that have been prepared in accordance with a financial reporting framework generally accepted in another country. The auditor's statement may also reference any note disclosure in the financial statements that describes significant differences between the accounting principles used and GAAP. An example of such a statement, which may be included in an emphasis-of-matter paragraph, is as follows:

> We also have reported separately on the financial statements of ABC Company for the same period presented in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]. (The significant differences between the [*specify the financial reporting framework generally accepted*] in [*name of country*] and accounting principles generally accepted in the United States of America are summarized in Note X.)

Reporting—Use in the United States (Ref: par. .13)

.A10 When reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country that will be used in the United States and outside the United States, the auditor may issue two reports: one of the reports described in paragraph .12 for use outside the United States and the U.S. form of report with an emphasis-of-matter paragraph, as described in paragraph .13, for use in the United States.

Exhibit — Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (Ref: par. .A7)

.A11

Illustration 1 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Illustration 2 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Illustration 1 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Independent Auditor's Report

[*Appropriate Addressee*]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of [*specify the financial reporting framework generally accepted*] in [*name of country*].

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and in [*name of country*]). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[1]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[1] In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Illustration 2 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Independent Auditor's Report

[*Appropriate Addressee*]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of *[specify the financial reporting framework generally accepted*] in [*name of country*].

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and in [*name of country*]). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the Company prepares its financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], which differ(s) from accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.[1]
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

[1]In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 915

Reports on Application of Requirements of an Applicable Financial Reporting Framework

Source: SAS No. 122; SAS No. 123; SAS No. 125.

Effective for engagements that end on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the reporting accountant's responsibilities when requested to issue a written report on

a. the application of the requirements of an applicable financial reporting framework to a specific transaction or

b. the type of report that may be issued on a specific entity's financial statements. (Ref: par. .A1)

.02 This section also applies to oral advice provided by the reporting accountant

a. that the reporting accountant concludes is intended to be used by a principal to the transaction as an important factor considered in reaching a decision on the application of the requirements of an applicable financial reporting framework to a specific transaction or

b. on the type of report that may be issued on a specific entity's financial statements.

.03 Differing interpretations may exist concerning whether and, if so, how existing accounting policies in an applicable financial reporting framework apply to new transactions or how new accounting policies in an applicable financial reporting framework apply to existing transactions. Management and others may consult with accountants on the application of the requirements of an applicable financial reporting framework to those transactions or to increase their knowledge of specific financial reporting issues. Such consultations may provide relevant information and insights not otherwise available.

.04 This section does not apply to

a. a continuing accountant with respect to the specific entity whose financial statements the continuing accountant has been engaged to report on,

b. engagements either to assist in litigation involving accounting or auditing matters or to provide expert testimony in connection with such litigation, or

c. professional advice provided to another accountant in public practice.

.05 This section also does not apply to communications such as position papers prepared by an accountant for the purpose of presenting views on an issue involving the application of the requirements of an applicable financial reporting framework, provided that these communications are not intended to provide guidance on the application of these requirements to a specific transaction. Position papers include newsletters, articles, speeches, and texts thereof; lectures and other forms of public presentations; and letters for the public record to professional and governmental standards-setting bodies.

Effective Date

.06 This section is effective for engagements that end on or after December 15, 2012.

Objective

.07 The objective of the reporting accountant, when engaged to issue a written report or provide oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements, is to address appropriately

a. the acceptance of the engagement.

b. the planning and performance of the engagement.

c. reporting on the specific transaction or type of report.

Definitions

.08 For purposes of this section, the following terms have the meanings attributed as follows:

Continuing accountant. An accountant who has been engaged to report on the financial statements of a specific entity or entities of which the specific entity is a component.

Hypothetical transaction. A transaction or financial reporting issue that does not involve facts or circumstances of a specific entity.

Reporting accountant. An accountant, other than a continuing accountant, in public practice, as described in ET section 0.400, *Definitions*, who prepares a written report or provides oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements.[1] (A reporting accountant who is also engaged to provide accounting and reporting advice to a specific entity on a recurring basis is commonly referred to as an advisory accountant.) (Ref: par. .A4)

Specific transaction. A completed or proposed transaction or group of related transactions or a financial reporting issue involving facts and circumstances of a specific entity.

Written report. Any written communication that provides a conclusion on the appropriate application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Engagement Acceptance

.09 In determining whether to accept the engagement, the reporting accountant should consider

a. the circumstances under which the written report or oral advice is requested,

b. the purpose of the request, and

c. the intended use of the written report or oral advice.

For purposes of this section, the reporting accountant is not required to be independent of the entity.

.10 The reporting accountant should accept an engagement to issue a written report on the application of the requirements of an applicable financial reporting framework to a specific transaction only when the transaction involves facts or circumstances of a specific entity. The reporting accountant should not accept an engagement to issue a written report on hypothetical transactions.

.11 If the reporting accountant has determined in accordance with paragraphs .09–.10 that it is appropriate to accept an engagement to be performed in accordance with this section, the reporting accountant should establish an understanding with the requesting party that

a. responsibility for the proper accounting treatment rests with management, who is expected to consult with its continuing accountant;

b. management acknowledges that the reporting accountant may need to consult with the continuing accountant and that, upon request, management will authorize the continuing accountant to respond fully to the reporting accountant's inquiries; and

c. management will notify those charged with governance and the continuing accountant concerning the nature of the engagement.

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[1][Footnote deleted, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

If management refuses to agree to authorize the continuing accountant to respond fully to the reporting accountant's inquiries, the reporting accountant should inquire about the reasons and consider the implications of that refusal when determining whether to accept the engagement.

Engagement Planning and Performance

.12 The reporting accountant should

a. obtain an understanding of the form and substance of the specific transaction(s) or the conditions relevant to the type of report that may be issued on a specific entity's financial statements;

b. review the relevant requirements of the applicable financial reporting framework, if appropriate;

c. consult with other professionals, experts, or regulatory authorities, if appropriate;

d. perform research or other procedures, as appropriate, to identify and consider existing creditable precedents or analogies;

e. except as provided in paragraph .13, request permission from the entity's management to consult with the continuing accountant and request the entity's management to authorize the continuing accountant to respond fully to the reporting accountant's inquiries; and

f. except as provided in paragraph .13, consult with the continuing accountant to determine the available facts relevant to forming a conclusion. (Ref: par. .A2–.A3)

Consulting With the Continuing Accountant

.13 The reporting accountant should consult with the continuing accountant to determine whether the reporting accountant has obtained the available facts relevant to form a conclusion, unless

a. the reporting accountant is engaged to issue a written report or provide oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction, as described in paragraphs .01*a* and .02*a*, and

b. the reporting accountant is engaged to provide recurring accounting and reporting advice (for example, bookkeeping or assistance in formulating accounting positions in selected matters, which are services commonly performed by an advisory accountant) and

   i. does not believe that a second opinion is being requested,

   ii. has full access to management, and

   iii. believes that the relevant information has been obtained in order to issue a written report or provide oral advice regarding the application of the requirements of an applicable financial reporting framework to an entity's specific transaction.

If the reporting accountant determines in accordance with the preceding *a*–*b* that it is not necessary to consult with the continuing accountant, the reporting accountant should document the rationale for not consulting. (Ref: par. .A2–.A4)

Written Report (Ref: par. .A5–.A7)

.14 The reporting accountant's written report should be addressed to the requesting party (for example, management or those charged with governance) and should include the following:

a. A brief description of the nature of the engagement and a statement that the engagement was performed in accordance with this section.

b. Identification of the specific entity; a description of the specific transaction(s), if applicable; a statement of the relevant facts, circumstances, and assumptions; and a statement about the source of such information.

c. A statement describing the appropriate application of the requirements of an applicable financial reporting framework (including the country of origin) to the specific transaction or type of report that may be issued on the entity's financial statements and, if appropriate, a description of the reasons for the reporting accountant's conclusion.

d. A statement that the responsibility for the proper accounting treatment rests with the preparers of the financial statements, who should consult with their continuing accountant.

e. A statement that any difference in the facts, circumstances, or assumptions presented may change the report.

f. An alert that restricts the use of the report solely to the specified parties, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.[2]

g. If the reporting accountant is not independent of the entity, a statement indicating the reporting accountant's lack of independence. The reporting accountant is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the reporting accountant chooses to provide the reasons for the lack of independence, the reporting accountant should include all the reasons therefor.

[As amended, December 2011, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

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[2]See paragraphs .06*a*–*b* and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01b)

.A1 Examples of the types of reports or illustrative report wording that a reporting accountant may provide include the following:

- A report expressing a modified opinion versus a report expressing an unmodified opinion
- A report prepared in accordance with auditing standards generally accepted in the United States of America versus a report prepared in accordance with international auditing standards
- Wording that might be included in a modified opinion

Engagement Planning and Performance

.A2 The responsibilities of an entity's continuing accountant to respond to inquiries by the reporting accountant are the same as the responsibilities of a predecessor auditor to respond to inquiries by the auditor. Section 210A, *Terms of Engagement*, addresses the responsibilities of a predecessor auditor.[3] (Ref: par. .12*f*–.13)

.A3 The continuing accountant may provide information related to the form and substance of the specific transaction that is not otherwise available to the reporting accountant regarding, for example, the following:

- How management has applied the requirements of an applicable financial reporting framework to similar transactions
- Whether the method of accounting recommended by the continuing accountant is disputed by management
- The continuing accountant's conclusion on the application of the requirements of an applicable financial reporting framework to the specific transaction or the type of report that may be issued on the entity's financial statements (Ref: par. .12*f*–.13)

.A4 When determining whether the criteria in paragraph .13 are satisfied such that consultation with the continuing accountant is not necessary, the reporting accountant may consider the following:

- The nature of the engagement
- Whether the reporting accountant believes that full knowledge of the form and substance of the transaction has been obtained

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[3]Paragraph .A30 of section 210A, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 125, December 2012.]

- How management has applied the requirements of the applicable financial reporting framework to similar transactions in the past
- Whether management has discussed the method of accounting with the continuing accountant

A recurring engagement for a reporting accountant may constitute the effective outsourcing of certain controllership or other financial reporting functions or involve financial reporting advisory services. Such an engagement may allow the reporting accountant to have complete access to management. (Ref: par. .08 and .13)

Written Report (Ref: par. .14)

.A5 Although the reporting requirements in paragraph .14 only apply to written reports, reporting accountants may find the requirements useful when providing oral advice.

.A6 The alert that restricts the use of the reporting accountant's written report referred to in paragraph .14*f* is not intended to preclude distribution of the report to the continuing accountant. [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

.A7 The exhibit "Illustrative Written Report to the Requesting Entity" provides an example of a written report to the requesting party.

Exhibit — Illustrative Written Report to the Requesting Party

.A8

The following is an illustration of the reporting accountant's written report to the requesting party (for example, management or those charged with governance) on the application of the requirements of accounting principles generally accepted in the United States of America to a specific transaction.

Introduction

We have been engaged to report on the appropriate application of the requirements of accounting principles generally accepted in the United States of America to the specific transaction described below. This report is being issued to ABC Company for assistance in evaluating accounting policies for the described specific transaction. Our engagement has been conducted in accordance with Statement on Auditing Standards No. 122 section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*.

Description of Transaction

The facts, circumstances, and assumptions relevant to the specific transaction as provided to us by the management of ABC Company are as follows:

[*Text discussing the facts, circumstances, and assumptions relevant to the specific transaction*]

Appropriate Accounting Principles

[*Text discussing accounting principles generally accepted in the United States of America and how they apply to the described transaction*]

Concluding Comments

The ultimate responsibility for the decision on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for an actual transaction rests with the preparers of financial statements, who should consult with their continuing accountant. Our conclusion on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for the described specific transaction is based solely on the facts provided to us as previously described; should these facts and circumstances differ, our conclusion may change.

Restricted Use

This report is intended solely for the information and use of those charged with governance and management of ABC Company and is not intended to be and should not be used by anyone other than these specified parties.

AU-C Section 920

Letters for Underwriters and Certain Other Requesting Parties

Source: SAS No. 122; SAS No. 125; SAS No. 129; SAS No. 140.

Effective for comfort letters issued on or after December 15, 2014, unless otherwise indicated.

Note

In March 2023, the Accounting Standards Board issued Statement on Auditing Standards No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for comfort letters issued on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when engaged to issue letters (commonly referred to as *comfort letters*) to requesting parties in connection with a nonissuer entity's financial statements included in registration statements filed with the Securities and Exchange Commission (SEC) under the Securities Act of 1933 (the 1933 Act) (for example, inclusion of the nonissuer entity's financial statements as required by either Rule 3-05 or 3-09 of Regulation S-X) or included in other securities offerings.

.02 Auditors' services include audits or reviews of financial statements included in securities offerings. In connection with the securities offerings, auditors are often requested to issue comfort letters to certain requesting parties. The auditor is not required by generally accepted auditing standards (GAAS) to accept an engagement to issue a comfort letter.

.03 The service of providing letters for underwriters developed following the passing of the 1933 Act. Section 11 of the 1933 Act provides that underwriters, among others, could be liable if any part of a registration statement contains material omissions or misstatements. The 1933 Act also provides for an affirmative defense for underwriters if it can be demonstrated that, after a reasonable investigation, the underwriter has reasonable grounds to believe that no material omissions or misstatements existed in a securities offering. An auditor issuing a comfort letter is one of a number of procedures that may be used to establish that an underwriter has conducted a reasonable investigation. Consequently, underwriters may request auditors to assist them in developing a record of reasonable investigation.

.04 The subjects that may be covered in a comfort letter include

- the independence of the auditor.
- whether the audited financial statements included in the securities offering comply regarding form, in all material respects, with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.
- unaudited financial statements, condensed interim financial information, capsule financial information, pro forma financial information, financial forecasts, management's discussion and analysis (MD&A), and changes in selected financial statement items during a period subsequent to the date and period of the latest financial statements included in the securities offering.
- tables, statistics, and other financial information included in the securities offering.
- negative assurance about whether certain nonfinancial statement information included in the securities offering complies regarding form, in all material respects, with Regulation S-K.[1]

Effective Date

.05 This section is effective for comfort letters issued on or after December 15, 2012.

Objectives

.06 The objectives of the auditor, when engaged to issue a letter to a requesting party in connection with an entity's financial statements included in a securities offering, are to

a. address appropriately the acceptance of the engagement and the scope of services; and

b. issue a letter with the appropriate form and content.

Definitions

.07 For purposes of this section, the following terms have the meanings attributed as follows:

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[1]Regulation S-K, "Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975."

Capsule financial information. Unaudited summarized interim financial information for periods subsequent to the periods covered by the audited financial statements or unaudited interim financial information included in the securities offering. Capsule financial information may be presented in narrative or tabular form and is often provided for the most recent interim period and for the corresponding period of the prior year.

Change period. The period ending on the cut-off date and ordinarily beginning, for balance sheet items, immediately after the date of the latest balance sheet in the securities offering and, for income statement items, immediately after the latest period for which such items are presented in the securities offering.

Closing date. The date on which the issuer of the securities or selling security holder delivers the securities in exchange for the proceeds of the offering.

Comfort letter. A letter issued by an auditor in accordance with this section to requesting parties in connection with an entity's financial statements included in a securities offering.

Comparison date and comparison period. The date as of which, and period for which, data at the cut-off date and data for the change period are to be compared.

Cut-off date. The date through which certain procedures described in the comfort letter are to relate.

Effective date. The date on which the securities offering becomes effective.

Entity. The party whose financial statements are the subject of the engagement.

Negative assurance. A statement that, based on the procedures performed, nothing has come to the auditor's attention that caused the auditor to believe that specified matters do not meet specified criteria (for example, that nothing came to the auditor's attention that caused the auditor to believe that any material modifications should be made to the unaudited interim financial information for it to be in accordance with generally accepted accounting principles).

Requesting party. One of the following specified parties requesting a comfort letter, which has negotiated an agreement with the entity:

- An underwriter
- Other parties that are conducting a review process that is, or will be, substantially consistent with the due diligence process performed when the securities offering is, or if the securities offering was, being registered pursuant to the 1933 Act, as follows:
  - — A selling shareholder, sales agent, or other party with a statutory due diligence defense under Section 11 of the 1933 Act
  - — A broker-dealer or other financial intermediary acting as principal or agent in a securities offering in connection with the following types of securities offerings:

    - Foreign offerings, including Regulation S, Eurodollar, and other offshore offerings
    - Transactions that are exempt from the registration requirements of Section 5 of the 1933 Act, including those pursuant to Regulation A, Regulation D, and Rule 144A
    - Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the 1933 Act

  — The buyer or seller in connection with acquisition transactions in which there is an exchange of stock (Ref: par. .A1)

Securities offerings. One of the following types of securities offerings:

- Registration of securities with the SEC under the 1933 Act
- Foreign offerings, including Regulation S, Eurodollar, and other offshore offerings
- Transactions that are exempt from the registration requirements of Section 5 of the 1933 Act, including those pursuant to Regulation A, Regulation D, and Rule 144A
- Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the 1933 Act
- Acquisition transactions in which there is an exchange of stock

Underwriter. As defined in the 1933 Act

> any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph, the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Except when the context otherwise requires, the word *underwriter*, as used in this section, refers to the managing, or lead, underwriter, who typically negotiates the underwriting agreement or purchase agreement (hereafter referred to as the *underwriting agreement*) for a group of underwriters whose exact composition is not determined until shortly before a securities offering becomes effective. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.08 References in this section to information that is *included* in a document are to be read to also encompass information that is *incorporated by reference* in that document.

Requirements

Engagement Acceptance

.09 The auditor should determine whether to accept an engagement to issue a comfort letter in connection with financial statements included in a securities offering. The auditor is neither required to accept such an engagement nor required to provide comfort on every matter requested when accepting an engagement to issue a comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.10 The auditor should provide a comfort letter in connection with financial statements included in a securities offering only to

a. underwriters.

b. other parties meeting the definition of a *requesting party* in paragraph .07.

.11 The auditor should request the requesting party to provide either

a. a written opinion from external legal counsel that the requesting party has a statutory due diligence defense under Section 11 of the 1933 Act; or (Ref: par. .A2)

b. a representation letter that

  i. is addressed to the auditor;

  ii. contains the statement, "The review process applied to the information relating to the issuer of the securities is (will be) substantially consistent with the due diligence process that we would perform if this securities offering were being registered pursuant to the Securities Act of 1933. We are knowledgeable with respect to that due diligence process."; and (Ref: par. .A3–.A4)

  iii. is signed by the requesting party. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.12 If a requesting party, other than an underwriter, requests a comfort letter but does not provide the legal opinion or representation letter described in paragraph .11, the auditor should not provide negative assurance on the financial statements as a whole, or on any of the specified elements, accounts, or items thereof. In such circumstances, the comfort letter should include the following statements: (Ref: par. .A5)

a. It should be understood that we have no responsibility for establishing (and did not establish) the scope and nature of the procedures enumerated in the preceding paragraphs; rather, the procedures enumerated therein are those that the requesting party asked us to perform. Accordingly, we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraphs; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages previously listed as set forth in the [*offering memorandum*]. Further, we have addressed ourselves solely to the foregoing data and make no representations regarding the adequacy of disclosures or whether any material facts have been omitted. This letter relates only to the financial statement items previously specified and does not extend to any financial statement of the company as a whole. (Ref: par. .A6)

b. The foregoing procedures do not constitute an audit or a review conducted in accordance with generally accepted auditing standards. Had we performed additional procedures or had we conducted an audit or a review of the company's [*give dates of any interim financial statements*] consolidated financial statements in accordance with auditing standards generally accepted in the United States of America, other matters might have come to our attention that would have been reported to you.

c. These procedures should not be taken to supplant any additional inquiries or procedures that you would undertake in your consideration of the proposed offering.

d. This letter is solely for your information and to assist you in your inquiries in connection with the offering of the securities covered by the [*offering memorandum*]. It is not to be used, circulated, quoted, or otherwise referred to for any other purpose, including but not limited to, the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the offering document or any other document, except that reference may be made to it in any list of closing documents pertaining to the offering of the securities covered by the offering document.

e. We have no responsibility to update this letter for events and circumstances occurring after [*cut-off date*]. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.13 The auditor should not provide a comfort letter to any parties other than a requesting party as defined in this section. (Ref: par. .A7)

.14 When issuing a letter in accordance with this section, the auditor should not circumvent the requirements of this section by issuing any additional letters or reports to a requesting party in connection with the securities offering in which the auditor comments on items for which commenting is otherwise precluded by this section.

Agreeing Upon the Scope of Services

.15 The auditor should obtain an understanding of the specific matters to be addressed in the comfort letter. (Ref: par. .A8)

.16 The auditor should ask to meet with the requesting party and the entity to discuss the procedures to be followed in connection with an engagement to issue a comfort letter. (Ref: par. .A9–.A10)

.17 The auditor should clearly communicate that the auditor cannot provide any assurance regarding the sufficiency of the procedures for the requesting party’s purposes. (Ref: par. .A11–.A14) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.18 The auditor should provide the requesting party with a draft of the form of the letter the auditor expects to furnish. To the extent possible, the draft should deal with all matters to be covered in the final letter and should use exactly the same terms as those to be used in the final letter, subject to the understanding that the comments in the final letter cannot be determined until the procedures underlying it have been performed. The draft letter should be identified as a draft to avoid giving the impression that the procedures described therein have been performed. (Ref: par. .A15) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.19 In both the draft and final forms of the comfort letter, the auditor should clearly describe the procedures performed by the auditor. The auditor should not state or imply that the auditor is carrying out such procedures as the auditor considers necessary because such statements or implications may lead to misunderstanding about the responsibility for the sufficiency of the procedures for the requesting party purposes.

.20 If the auditor has been unable to have a discussion with the requesting party about the auditor's planned procedures, the auditor should describe in the draft letter those procedures specified in the draft underwriting agreement that the auditor is willing to perform. (Ref: par. .A16–.A17)

.21 Situations may exist in which one or more component auditor's report is included in the securities offering. When comfort letters are issued to requesting parties by those component auditors, the auditor of the group financial statements should read those comfort letters. The auditor of the group financial statements should state in the comfort letter that the procedures relating to those components consisted solely of reading the component auditors' comfort letters. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.22 When comfort letters are requested from more than one auditor, the requirements of this section apply to each auditor. (Ref: par. .A19)

.23 In competitive bidding situations in which legal counsel for the requesting party acts as the requesting party's representative prior to opening and acceptance of the bid, the auditor should carry out the discussions and other communications required by this section with the legal counsel until the requesting party is selected. In such circumstances, the auditor should not agree to provide a comfort letter addressed to the entity, legal counsel, or a nonspecific addressee, such as "any or all underwriters to be selected." If the auditor agrees to provide a draft comfort letter, the draft comfort letter should include a legend describing the letter's purpose and limitations. (Ref: par. .A20–.A23)

Format and Contents of Comfort Letters

Dating

.24 The letter should state that the inquiries and other procedures described in the letter did not cover the period from the cut-off date to the date of the letter. (Ref: par. .A24–.A25)

.25 When an additional letter, dated at or shortly before the closing date, is requested, the auditor should carry out the specified procedures and inquiries as of the cut-off date for each letter. The subsequent letter should relate only to information in the securities offering as most recently amended. (Ref: par. .A26)

Addressee

.26 The letter should be addressed only to the requesting party, or both the requesting party and the entity, and should not be provided to any other parties. (Ref: par. .A27)

Introductory Paragraph

.27 The letter should contain an introductory paragraph that identifies the financial statements and the securities offering.

Auditor's Report

.28 The auditor should, in the comfort letter, make reference to, but not repeat, the report on the audited financial statements included in the securities offering. (Ref: par. .A28)

.29 When the auditor's report on the audited financial statements included in the securities offering contains an emphasis-of-matter or other-matter paragraph or a separate section in the auditor's report addressing matters other than consistency of application of accounting policies,[2] the auditor should refer to that fact in the comfort letter and discuss the subject matter of the paragraph. In those instances in which the SEC accepts a modified opinion on historical financial statements, the auditor should refer to the modification in the opening paragraph of the comfort letter and discuss the subject matter of the modification. (Ref: par. .A29–.A30) [As amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

.30 The auditor should not provide negative assurance regarding the auditor's report or regarding financial statements that have been audited and are reported on in the securities offering by other auditors. (Ref: par. .A31)

.31 In the introductory paragraph of the comfort letter, if the auditor refers to reports that the auditor has previously issued other than the report on the audited financial statements included in the securities offering, the auditor should not repeat the reports in the comfort letter or otherwise imply that the auditor is reporting as of the date of the comfort letter or assuming responsibility for the sufficiency of the procedures for the requesting party's purposes. (Ref: par. .A32–.A33)

[.32] [Paragraph deleted, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

.33 The auditor should not mention, refer to, or attach to the comfort letter any report or other auditor's written communication that includes an alert that restricts the use of the auditor's written communication, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, or any restricted use reports issued in

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[2]See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

accordance with Statements on Standards for Attestation Engagements or Statements on Standards for Accounting and Review Services. (Ref: par. .A34) [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

Representations

.34 The auditor should refer in the comfort letter to the requesting party's representations when the representation letter described in paragraph .11 has been provided. (Ref: par. .A35)

Independence

.35 The auditor should state in the comfort letter that the auditor is independent, or the date through which the auditor was independent, with respect to the entity, and identify the applicable independence rules. (Ref: par. .A36–.A38)

Compliance With SEC Requirements

.36 If the auditor is requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, the auditor's opinion should refer to compliance as to form, in all material respects, with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC. (Ref: par. .A39–.A41)

.37 Certain financial statements may be incorporated in a registration statement under the 1933 Act by reference to filings under the Securities Exchange Act of 1934 (the 1934 Act). If the auditor is requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, the auditor's opinion should refer to whether the audited financial statements incorporated by reference in the registration statement comply as to form, in all material respects, with the applicable accounting requirements of the 1934 Act and the related rules and regulations adopted by the SEC. However, the auditor should not opine on compliance with the provisions of the 1934 Act regarding internal control over financial reporting.

.38 If the auditor has been requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, and a material departure from the pertinent rules and regulations adopted by the SEC exists, the auditor should disclose the departure in the comfort letter. (Ref: par. .A42)

.39 The auditor should express an opinion on compliance as to form with requirements under the rules and regulations adopted by the SEC only with respect to those rules and regulations applicable to the form and content of financial statements that the auditor has audited. When the financial statements or financial statement schedules have not been audited, the auditor is limited to providing negative assurance on compliance as to form.

.40 The auditor should not comment in a comfort letter on compliance as to form of MD&A with rules and regulations adopted by the SEC. (Ref: par. .A43)

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

General

.41 When commenting in a comfort letter on information other than audited financial statements, the auditor should

a. describe the procedures performed by the auditor, as required by paragraph .19. (Ref: par. .A44–.A46)

b. describe the criteria specified by the requesting party.

c. state that the procedures performed with respect to interim periods may not disclose matters of significance regarding certain matters about which negative assurance is requested. (Ref: par. .A47–.A48)

.42 The auditor should not, in the comfort letter

a. make any statements, or imply, that the auditor has applied procedures that the auditor determined to be necessary or sufficient for the requesting party's purposes.

b. use terms of uncertain meaning (such as *general review*, *limited review*, *reconcile*, *check*, or *test*) in describing the work unless the procedures encompassed by these terms are described in the comfort letter.

c. make a statement that nothing else has come to the auditor's attention that would be of interest to the requesting party as a result of carrying out the specified procedures. (Ref: par. .A49)

.43 When the report on the audited financial statements in the securities offering is a modified report, the auditor should consider the effect on providing negative assurance in the comfort letter regarding subsequent interim financial information included in the securities offering or regarding an absence of specified subsequent changes. The auditor should also follow the requirements of paragraph .29. (Ref: par. .A50)

Knowledge of Internal Control

.44 The auditor should obtain an understanding of the entity's internal control over financial reporting for both annual and interim periods when commenting in a comfort letter on

a. unaudited interim financial information, including unaudited condensed interim financial information;

b. capsule financial information;

c. a financial forecast when historical financial statements provide a basis for one or more significant assumptions for the forecast; or

d. subsequent changes in specified financial statement items. (Ref: par. .A51)

Unaudited Interim Financial Information

.45 The auditor should provide negative assurance on unaudited interim financial information included in the securities offering only if the auditor has conducted a review of the interim financial information in accordance with GAAS applicable to reviews of interim financial information. If the auditor has not conducted a review in accordance with GAAS applicable to reviews of interim financial information, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A52)

.46 The negative assurance provided regarding such unaudited interim financial information should be about whether

a. any material modifications should be made to the unaudited interim financial information for it to be in accordance with the applicable financial reporting framework, and

b. the unaudited interim financial information complies as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC, if applicable. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.47 If the auditor states in the comfort letter that the auditor has issued a review report on the unaudited interim financial information, the auditor should attach the review report to the letter unless the review report is already included in the securities offering. (Ref: par. .A53) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.48 The auditor should specifically identify, in the comfort letter, any unaudited interim financial information and should state that the auditor has not audited the interim financial information in accordance with GAAS and does not express an opinion concerning such information. (Ref: par. .A54–.A55)

Capsule Financial Information

.49 The auditor should not provide negative assurance regarding whether the selected capsule financial information is in accordance with the applicable financial reporting framework unless

a. the auditor has performed a review of the financial statements underlying the capsule financial information in accordance with GAAS applicable to reviews of interim financial information, and

b. the selected capsule financial information is in accordance with minimum disclosure requirements of the applicable financial reporting framework for interim financial information.

If these conditions have not been met, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A56) [Renumbered by the issuance of SAS No. 129, July 2014.]

.50 The auditor should not provide negative assurance on selected capsule financial information regarding whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements unless the auditor has performed a review of the financial statements underlying the capsule financial information in accordance with GAAS applicable to reviews of interim financial information. Otherwise, the auditor is limited to reporting procedures performed and findings obtained. [Renumbered and amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.51 When the auditor is requested by the requesting party to provide negative assurance on unaudited condensed interim financial information, or information extracted therefrom, for a period ending after the latest financial statements included in the securities offering, the requirements in paragraphs .45–.48 apply. When the auditor provides negative assurance on such information, a copy of the unaudited interim financial information should be attached to the comfort letter. (Ref: par. .A57) [Renumbered and amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Pro Forma Financial Information

.52 The auditor should not comment in a comfort letter on pro forma financial information unless the auditor has an appropriate level of knowledge of the accounting and financial reporting practices of the entity. (Ref: par. .A58)

.53 The auditor should not provide negative assurance in a comfort letter on pro forma financial information, including negative assurance on

- the application of pro forma adjustments to historical amounts,
- the compilation of pro forma financial information, or
- whether the pro forma financial information complies as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X,[3] or with the pro forma bases as described in the pro forma financial information, as applicable,

unless the auditor has obtained the required knowledge described in paragraph .52 and has performed

[3]Regulation S-X, "Form and Content of and Requirements for Financial Statements, Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Investment Company Act of 1940, and Energy Policy and Conservation Act of 1975."

a. an audit of the annual financial statements, or

b. a review of the interim financial information, in accordance with GAAS applicable to reviews of interim financial information,

of the entity (or, in the case of a business combination, of a significant constituent part of the combined entity) to which the pro forma adjustments were applied. In the case of a business combination, the historical financial statements of each constituent part of the combined entity on which the pro forma financial information is based should be audited or reviewed. If these conditions are not met, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A59) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Financial Forecasts

.54 When performing procedures agreed to with the requesting party on a financial forecast and commenting thereon in a comfort letter, the auditor should

a. obtain an understanding of the entity's internal control over financial reporting for both annual and interim periods, as required by paragraph .44;

b. perform procedures required by AR-C section 80A, *Compilation Engagements*, for reporting on the compilation of a forecast;[4]

c. issue a report on the compilation of prospective financial information in accordance with AR-C section 80A and attach the report thereon to the comfort letter;[5] and

d. perform additional procedures as requested by the requesting party and report the findings in the comfort letter. (Ref: par. .A60–.A61)

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

.55 The auditor should not provide negative assurance on the results of procedures performed on a financial forecast.

.56 The auditor should not provide negative assurance with respect to compliance of the financial forecast with Rule 11-03 of Regulation S-X unless the auditor has performed an examination of the financial forecast in accordance with AT-C section 305, *Prospective Financial Information*. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.57 If a financial forecast that the auditor has not examined is included in the securities offering, the auditor should not issue a comfort letter unless the financial forecast is accompanied by an indication that the auditor has not examined the financial forecast

[4] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

[5] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

and, therefore, does not express an opinion on it. (Ref: par. .A62) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Subsequent Changes

.58 The auditor should base comments regarding subsequent changes in specified financial statement items solely on the limited procedures performed with respect to the change period as determined by the requesting party. (Ref: par. .A63–.A65)

.59 The auditor should provide negative assurance in the comfort letter regarding subsequent changes in specified financial statement items only as of a date less than 135 days from the end of the most recent period for which the auditor has performed an audit or a review. (Ref: par. .A66)

.60 When the requesting party requests negative assurance regarding subsequent changes in specified financial statement items as of a date 135 days or more from the end of the most recent period for which the auditor has performed an audit or a review, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A67) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.61 In commenting on subsequent changes, the auditor should not characterize subsequent changes using ambiguous terms, such as referring to the change as "adverse." The auditor should note in the comfort letter if there has been a change in the application of the requirements of the applicable financial reporting framework. (Ref: par. .A68) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.62 The auditor should comment only on the occurrence of subsequent changes in specified financial statement items that are not disclosed in the securities offering. Accordingly, the auditor should include the phrase *except for changes, increases, or decreases that the securities offering discloses have occurred or may occur* in the comfort letter when it has come to the auditor's attention that a change, increase, or decrease has occurred during the change period, and the amount of such change, increase, or decrease is disclosed in the securities offering. This phrase need not be included in the letter when no changes, increases, or decreases in the specified financial statement items are disclosed in the securities offering. (Ref: par. .A69–.A70)

.63 The auditor should identify in the comfort letter in both draft and final form the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared, whether or not specified in the underwriting agreement. (Ref: par. .A71–.A72)

.64 If the requesting party requests the use of a change period or periods other than those described in paragraph .07, the auditor should explain to the requesting party the implications of using an earlier date. If the requesting party, nonetheless, requests the use of a change period or periods other than those described in paragraph .07, the auditor is permitted to use the period or periods requested. (Ref: par. .A73)

Tables, Statistics, and Other Financial Information

.65 The auditor should not comment in a comfort letter on tables, statistics, and other financial information appearing in the securities offering unless the information

a. is expressed in dollars (or percentages derived from such dollar amounts) and has been obtained from accounting records that are subject to internal control over financial reporting, or

b. has been derived directly from such accounting records by analysis or computation. (Ref: par. .A74)

.66 The auditor should not comment in a comfort letter on quantitative information that has been obtained from accounting records unless the information is subject to the same controls over financial reporting as the dollar amounts.

.67 The auditor should not comment in a comfort letter on tables, statistics, and other financial information relating to an unaudited period unless the auditor has

a. performed an audit of the entity's financial statements for a period including, or immediately prior to, the unaudited period or completed an audit for a later period, or

b. otherwise obtained knowledge of the entity's internal control over financial reporting.

.68 The auditor should not use the term *presents fairly* in comments concerning tables, statistics, and other financial information (Ref: par. .A75) and should not comment on

a. information subject to legal interpretation, such as beneficial share ownership;

b. nonfinancial data presented in MD&A, unless the auditor has conducted an examination or review of MD&A in accordance with AT-C section 395, *Management's Discussion and Analysis*; or (Ref: par. .A76)

c. matters merely because the auditor is capable of reading, counting, measuring, or performing other functions that might be applicable.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.69 The auditor's comments in the comfort letter concerning tables, statistics, and other financial information included in the securities offering should include

a. a clear identification of the specific information commented on;

b. a description of the procedures performed; and

c. the findings, expressed in terms of agreement between items compared. (Ref: par. .A77–.A78)

.70 With respect to the acceptability of methods of allocation used in deriving the figures commented on, the auditor should comment only to the extent to which such allocation is made in, or can be derived directly by analysis or computation from, the entity's accounting records. Such comments, if made, should make clear that

a. such allocations may be, to a substantial extent, arbitrary.

b. the method of allocation used is not the only acceptable method.

c. other acceptable methods of allocation might produce significantly different results.

.71 The comfort letter should state that the auditor makes no representations regarding

a. any matter of legal interpretation;

b. the completeness or adequacy of disclosure; and

c. the adequacy of the procedures followed, and that such procedures would not necessarily disclose material misstatements or omissions in the information to which the comments relate. (Ref: par. .A79–.A80)

Compliance as to Form With Regulation S-K

.72 The auditor should not provide negative assurance about whether certain financial information in registration statements, included because of specific requirements of Regulation S-K, is in conformity with the disclosure requirements of Regulation S-K unless the following conditions are met:

a. The information is derived, directly or by analysis or computation, from the accounting records subject to internal control over financial reporting.

b. The information is capable of evaluation against reasonable criteria that have been established by the SEC. (Ref: par. .A81 and .A84–.A87)

.73 The auditor should not express an opinion on conformity with the disclosure requirements of Regulation S-K. (Ref: par. .A82–.A83)

Concluding Paragraph

.74 The comfort letter should include a concluding paragraph restricting the use of the comfort letter for the information of the addressees and to assist the requesting parties in connection with the securities offering. (Ref: par. .A88)

Disclosure of Subsequently Discovered Matters

.75 The auditor should inform the entity when the auditor has discovered matters that require mention in the final comfort letter but were not mentioned in the draft letter that has been furnished to the requesting party. If the entity decides that disclosure will not be made in the securities offering, the auditor should inform the entity that the matters will be mentioned in the comfort letter and should recommend that the requesting party be informed promptly. (Ref: par. .A89–.A90)

Application and Other Explanatory Material

Definitions (Ref: par. .07)

.A1 An example of a comfort letter in connection with an acquisition transaction in which there is an exchange of stock is a cross-comfort letter related to a typical Form S-4 or merger proxy situation. An auditor's report on a preliminary investigation in connection with a proposed transaction (for example, a merger, an acquisition, or a financing) is not covered by this section; the guidance in AT-C section 215, *Agreed-Upon Procedures Engagements*, may apply to such engagements. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Engagement Acceptance (Ref: par. .09–.13)

.A2 An attorney's letter indicating that a party "may" be deemed to be an underwriter or has liability substantially equivalent to that of an underwriter under the securities laws would not meet this requirement.

.A3 What is "substantially consistent" may vary from situation to situation and may not be the same as that done in a registered offering of the same securities for the same entity. Whether the procedures being, or to be, followed will be "substantially consistent" is determined by the requesting party on a case-by-case basis. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A4 Exhibit A, "Illustration of Representation Letter From Requesting Party," contains illustrative wording for a representation letter when the requesting party is not an underwriter.

.A5 Exhibit B, "Examples of Comfort Letters," contains examples of comfort letters. Example Q, "Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11," of this exhibit provides an example of a comfort letter issued to a requesting party that has not provided the representation letter described in paragraph .11.

.A6 Interpretation No. 1, "Responding to Requests for Reports on Matters Relating to Solvency" (AT-C sec. 9105 par. .01–.11), of AT-C section 105, *Concepts Common to All Attestation Engagements*, contains guidance on additional statements to be included if this comfort letter is requested in connection with a secured debt offering. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A7 Although the auditor is not permitted to provide a comfort letter other than to requesting parties, the auditor, instead, may provide a report on agreed-upon procedures. AT-C section 215 provides guidance on such reports. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Agreeing Upon the Scope of Services (Ref: par. .15–.23)

.A8 The underwriting agreement may specify the matters to be addressed in the comfort letter. If the underwriting agreement or draft underwriting agreement is not available or does not specify the matters to be addressed, the understanding of the scope of the comfort letter may be obtained from a description furnished by the entity or requesting party. Obtaining this understanding as early as possible, and before the auditor provides a draft of the form of the letter the auditor expects to furnish, assists the auditor in determining whether the auditor will be able to furnish a letter in acceptable form.

.A9 If the requesting party refuses to meet together with the entity, the auditor may consider the implications in determining whether to accept the engagement.

.A10 During this meeting, the auditor may describe procedures that are frequently followed. Exhibit B provides examples of comfort letters that include these procedures. Because of the auditor's knowledge of the entity, such a meeting may assist the requesting party in reaching a decision about procedures to be followed by the auditor.

.A11 When financial information in a securities offering has not been audited in accordance with GAAS and, accordingly, is not covered by an auditor's opinion, the nature of the comments that the auditor can properly make with respect to that financial information is limited. As noted in paragraph .03, obtaining a comfort letter from an auditor is one procedure used by a requesting party to establish that the requesting party has conducted a "reasonable investigation," as a defense against possible claims under Section 11 of the 1933 Act. What constitutes a reasonable investigation of unaudited financial information sufficient to satisfy a requesting party's purposes is a matter of legal interpretation. Consequently, only the requesting party can determine what is sufficient for the requesting party's purposes.

.A12 The assistance that the auditor can provide by way of a comfort letter is subject to limitations. One limitation is that auditors can properly comment in their professional capacity only on matters to which their professional expertise is relevant. Another limitation is that procedures contemplated in a comfort letter, which do not constitute an audit of financial statements, do not provide the auditor with a basis for expressing an opinion. Such limited procedures may bring to the auditor's attention significant findings or issues affecting the financial information, but they do not provide assurance that the auditor will become aware of any or all significant findings or issues that would be disclosed in an audit. Accordingly, a risk exists that the auditor may have provided negative assurance on the absence of conditions or matters that may prove to have existed.

.A13 Comfort letters are not required under the 1933 Act, and copies are not filed with the SEC. Nonetheless, it is a common condition of an underwriting agreement in connection with the offering for sale of securities registered with the SEC under the 1933 Act that the auditor is to furnish a comfort letter. Some underwriters do not make the receipt of a comfort letter a condition of the underwriting agreement but, nevertheless, ask for such a letter.

.A14 Exhibit B, example A-1, "Typical Comfort Letter for a 1933 Act Offering," provides an illustration of an appropriate way of expressing that the auditor cannot provide any assurance regarding the sufficiency of the procedures for the requesting party's purposes.[6]

.A15 By providing a draft letter early in the process, the auditor has the opportunity to clearly show the requesting party what they may expect to receive from the auditor. Thus, the requesting party has the opportunity to discuss further with the auditor the procedures that the auditor expects to perform and to request any additional procedures that the requesting party may desire. If the additional procedures pertain to matters relevant to the auditor's professional competence and the auditor is willing to perform them, a revised draft may be prepared.

.A16 Acceptance by the requesting party of the draft comfort letter (and subsequently by acceptance of the comfort letter in final form) is an indication to the auditor that the requesting party considers the procedures described to be sufficient for the requesting party's purposes. Clearly describing the procedures to be followed by the auditor in the comfort letter avoids misunderstanding about the basis on which the auditor's comments have been made and assists the requesting party in deciding whether the procedures performed are sufficient for the requesting party's purposes.

.A17 The following is an example of a paragraph that may be placed on the draft letter for identification and explanation of its purposes and limitations.

> This draft is furnished solely for the purpose of indicating the form of letter that we would expect to be able to furnish [*name of requesting party*] in response to their request, the matters expected to be covered in the letter, and the nature of the procedures that we would expect to carry out with respect to such matters. Based on our discussions with [*name of requesting party*], it is our understanding that the procedures outlined in this draft letter are those they wish us to follow. Unless [*name of requesting party*] informs us otherwise, we shall assume that there are no additional procedures they wish us to follow. The text of the letter itself will depend, of course, on the results of the procedures, which we would not expect to complete until shortly before the letter is given and in no event before the cut-off date indicated therein.

If the auditor has not had any discussions with the requesting party about the auditor's planned procedures, the second sentence in this paragraph would be revised as follows: "In the absence of any discussions with [*name of requesting party*], we have set out in this draft letter those procedures referred to in the draft underwriting agreement (of which we have been furnished a copy) that we are willing to follow."

[.A18] [Paragraph deleted by the issuance of SAS No. 129, July 2014.]

.A19 Comfort letters are requested occasionally from more than one auditor, for example, in connection with securities offerings to be used in the subsequent sale of shares issued

[6]Paragraph 4 of example A-1, "Typical Comfort Letter for a 1933 Act Offering," in exhibit B, "Examples of Comfort Letters."

in recently effected mergers and from predecessor auditors. In such circumstances, it is the entity's responsibility, at the earliest practicable date, to inform any other auditors who may be involved about any letter that may be requested of them and arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter and for the performance of their procedures. The entity or requesting party is also responsible for arranging for a copy of the comfort letters of component auditors in draft and final form to be provided to the auditor of the group financial statements.

.A20 In certain circumstances, regulations under the 1933 Act permit companies to register a designated amount of securities for continuous or delayed offerings during an extended period by filing one "shelf" registration statement. At the effective date of a shelf registration statement, the registrant may not yet have selected an underwriter. An entity or the legal counsel designated to represent the underwriting group may, however, ask the auditor to issue a comfort letter at the effective date of a shelf registration statement to expedite the due diligence activities of the underwriter when subsequently designated and to avoid later corrections of financial information included in an effective prospectus. However, as stated in paragraph .A11, only the underwriter can determine the procedures that will be sufficient for the underwriter's purposes.

.A21 The auditor may agree to furnish the entity or legal counsel for the underwriting group with a draft comfort letter describing the procedures that the auditor has performed and the comments that the auditor is willing to express as a result of those procedures.

.A22 The following is an example of a legend describing the letter's purpose and limitations.

> This draft describes the procedures that we have performed and represents a letter we would be prepared to sign if the managing underwriter had been chosen and requested such a letter. The text of the final letter will depend, of course, on whether the managing underwriter who is selected requests that these and other procedures be performed to meet his or her needs and whether the managing underwriter requests that any of the procedures be updated to the date of issuance of the signed letter.

.A23 A signed comfort letter may be issued to the underwriter selected for the portion of the issue then being offered when the underwriting agreement for an offering is signed and on each closing date.

Format and Contents of Comfort Letters

Dating (Ref: par. .24–.25)

.A24 The letter ordinarily is dated on, or shortly after, the underwriting agreement is signed.

.A25 The underwriting agreement ordinarily specifies the date, often referred to as the *cut-off date*, to which certain procedures described in the letter are to relate, for example, a date five days before the date of the letter. A factor in considering whether to accept the engagement is whether the period between the cut-off date and the date of the letter provides sufficient time to allow the auditor to perform the procedures and prepare the letter.

.A26 Comments included in an earlier letter that relate to information in the securities offering as most recently amended may be incorporated by reference in a subsequent letter. Exhibit B, example C, "Letter Reaffirming Comments as of a Later Date," provides an example of such reference. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Addressee (Ref: par. .26)

.A27 An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters." Copies of a comfort letter addressed in accordance with the requirements in paragraph .26 may be provided to the auditor of the group financial statements when a comfort letter related to a component included in group financial statements is issued by a component auditor.

Auditor's Report (Ref: par. .28–.33)

.A28 The requesting party might request that the auditor repeat in the comfort letter the report on the audited financial statements included in the securities offering. Because of the significance of the date of the auditor's report, the auditor is not permitted to agree to this request. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A29 An example of a matter addressed in an emphasis-of-matter or other-matter paragraph in the auditor's report that does not affect the opinion on the basic financial statements is interim financial information accompanying or included in the notes to audited financial statements.[7] An example of a matter addressed in a separate section in the auditor's report that does not affect the opinion on the basic financial statements is required supplementary information described in section 730, *Required Supplementary Information*.[8] [As amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

.A30 A requesting party may request that the auditor comment in the comfort letter on

- unaudited interim financial information required by item 302(a) of Regulation S-K, or
- required supplementary information.

Section 930, *Interim Financial Information*, applies to unaudited interim financial information, and section 730 applies to required supplementary information. These sections require the auditor to modify the auditor's report on the audited financial statements to refer to such information when

[7] Paragraphs .40–.41 of section 930, *Interim Financial Information*. [Footnote amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

[8] Paragraphs .07–.09 of section 730, *Required Supplementary Information*.

- the scope of the procedures with regard to the information was restricted, or
- when the information appears not to be presented in accordance with the applicable financial reporting framework or, for required supplementary information, applicable guidelines.

Such modifications of the auditor's report in the securities offering would ordinarily be referred to in the opening paragraph of the comfort letter (see also paragraph .43). Additional comments on such unaudited information are, therefore, unnecessary. However, if the requesting party requests that the auditor perform procedures with regard to such information in addition to those procedures performed in connection with the review or audit as prescribed by section 930 and section 730, the auditor may do so and report the findings. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A31 The requesting party might request negative assurance regarding the auditor's report. Because auditors have a statutory responsibility with respect to their opinion as of the effective date of a securities offering and because the additional significance, if any, of negative assurance is unclear and such assurance may, therefore, give rise to misunderstanding, the auditor is not permitted to provide such negative assurance. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A32 In the introductory paragraph of the comfort letter, the auditor may refer to the fact that the auditor has issued reports on

- summary financial statements that are derived from audited financial statements.[9]
- interim financial information.[10]
- pro forma financial information.[11]
- a financial forecast.[12]
- MD&A.[13]

.A33 When the auditor makes reference to having issued a review report on the interim financial information, the auditor is required by paragraph .47 to attach the review report to the comfort letter if the review report is not included in the securities offering. The other reports listed in paragraph .A32 may also be attached to the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

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[9]See section 810, *Engagements to Report on Summary Financial Statements.*

[10]See section 930.

[11]See AT-C section 310, *Reporting on Pro Forma Financial Information*, and AR-C section 120, *Compilation of Pro Forma Financial Information*. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 22.]

[12]See AR-C section 80A. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

[13]See AT-C section 395, *Management's Discussion and Analysis*. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A34 An example of an auditor's written communication that includes an alert that restricts the use of the auditor's written communication that is not permitted to be mentioned, referred to, or attached to the comfort letter is an auditor's written communication issued in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*. Examples of restricted use reports that are not permitted to be mentioned, referred to, or attached to the comfort letter include a report on agreed-upon procedures and any restricted use report issued in connection with procedures performed on the entity's internal control over financial reporting, in accordance with section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*. [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125; Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SAS No. 130.]

Representations (Ref: par. .34)

.A35 Exhibit B, example A-2, "Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained," contains a reference to the requesting party's representations.

Independence (Ref: par. .35)

.A36 Exhibit B, example A-1 contains an illustration of an appropriate statement confirming the auditor's independence under SEC rules and regulations in conjunction with SEC filings.

.A37 Exhibit B, example A-2 includes an illustration of an appropriate statement confirming the auditor's independence in conjunction with a securities offering when the auditor is independent under AICPA standards.

.A38 The auditors for previously nonaffiliated entities recently acquired by the registrant would not be required to have been independent with respect to the entity whose shares are being registered. Exhibit B, example B, "Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference," includes an illustration of an appropriate statement concerning the auditor's independence in such a case.

Compliance With SEC Requirements (Ref: par. .36–.40)

.A39 Although the guidance in this section generally addresses comfort letters issued in connection with securities offerings registered pursuant to the 1933 Act, it also provides guidance on comfort letters issued in other securities transactions. However, the guidance that specifically refers to compliance of the information commented on with SEC rules and regulations, such as compliance with Regulation S-X or S-K, generally applies only to comfort letters issued in connection with securities offerings registered pursuant to the 1933 Act.

.A40 The phrase *rules and regulations adopted by the SEC* is used because auditors are not expected to be familiar with, or express opinions on compliance with, informal positions of the SEC staff.

.A41 An illustration of an appropriate opinion regarding compliance as to form with pertinent accounting requirements adopted by the SEC is as follows:

> In our opinion [*include phrase* except as disclosed in the registration statement *if applicable*], the [*identify the financial statements and financial statement schedules*] audited by us and included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.

.A42 Exhibit B, example K, "Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements," illustrates an appropriate manner of disclosing a material departure from the pertinent rules and regulations adopted by the SEC.

.A43 The auditor may agree to examine or review MD&A in accordance with AT-C section 395. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

General (Ref: par. .41–.43)

.A44 Comments included in the letter will often concern

- unaudited interim financial information.
- capsule financial information.
- pro forma financial information.
- financial forecasts.
- subsequent changes in specified financial statement items.

When the auditor has been requested to provide negative assurance on interim financial information or capsule financial information, the procedures involved in a review performed in accordance with GAAS applicable to reviews of interim financial information need not be specified.

.A45 Exhibit B, example A-1 contains an illustration of how the procedures performed by the auditor may be described.[14]

.A46 If the auditor states that the auditor has performed a review in accordance with GAAS applicable to reviews of interim financial information, this does not imply that those procedures are sufficient for the requesting party's purposes. The requesting party may ask the auditor to perform additional procedures. For example, the requesting party

[14]Paragraph 4 of example A-1 in exhibit B.

may request that the auditor apply additional procedures and specify items of financial information to be reviewed and the materiality level for changes in those items that would necessitate further inquiry by the auditor.

.A47 The procedures performed with respect to interim periods may not disclose subsequent changes in the specified financial statement items, inconsistencies in the application of the applicable financial reporting framework, instances of noncompliance as to form with accounting requirements of the SEC, or other matters about which negative assurance is requested.

.A48 An illustration of an appropriate manner of noting the limitations of procedures performed is shown in example A-1 of exhibit B.[15]

.A49 Because there is no way for the auditor to anticipate other matters that would be of interest to a requesting party, the auditor is precluded, in accordance with paragraph .42, from making a statement that nothing else has come to the auditor's attention that would be of interest to the requesting party.

.A50 Exhibit B, example I, "Alternate Wording When Auditor's Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph," contains an illustration of alternate wording when the auditor's report on audited financial statements is a modified report.

Knowledge of Internal Control (Ref: par. .44)

.A51 The auditor may have obtained a sufficient understanding of an entity's internal control over financial reporting for both annual and interim periods through performing an audit on the entity's financial statements for one or more periods.

Unaudited Interim Financial Information (Ref: par. .45–.48)

.A52 The SEC requirements specify condensed financial statements. However, the requirements in paragraphs .45–.48 also apply to complete financial statements. For purposes of this section, interim financial information may be for a 12-month period ending on a date other than the entity's normal year-end. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A53 The auditor may, but is not required to, state in the comfort letter that the auditor has performed a review of interim financial information in accordance with GAAS applicable to reviews of interim financial information, and has issued a report on the review.

.A54 Exhibit B, example A-1 provides an illustration of a description related to the procedures specified for a review in accordance with GAAS applicable to reviews of interim financial information.[16] Exhibit B, example O, "Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing

[15] See the last three sentences in paragraph 4 of example A-1 in exhibit B.

[16] Paragraphs 4*a* and 5*a* of example A-1 in exhibit B.

Standards Applicable to Reviews of Interim Financial Information," provides an illustration of alternate wording when the procedures that the requesting party has requested the auditor to perform on interim financial information are less than a review in accordance with GAAS applicable to reviews of interim financial information.

.A55 Exhibit B, example A-1 includes an illustration of an appropriate manner of making clear that the auditor is not expressing an opinion on unaudited interim financial information.[17]

Capsule Financial Information (Ref: par. .50–.51)

.A56 In some securities offerings, supplementary capsule financial information comprising unaudited summarized interim financial information for subsequent periods accompanies the information shown in the audited financial statements or unaudited interim financial information. This capsule financial information (either in narrative or tabular form) often is provided for the most recent interim period and for the corresponding period of the prior year.

.A57 The requesting party may ask the auditor to provide negative assurance with respect to the unaudited interim financial information, or unaudited condensed interim financial information that underlie the capsule financial information, and ask the auditor to state that the capsule financial information agrees with amounts set forth in such financial information. Exhibit B, example L, "Alternate Wording When Recent Earnings Data Are Presented in Capsule Form," provides an illustration of the auditor's comments in these circumstances.[18]

Pro Forma Financial Information (Ref: par. .52–.53)

.A58 An appropriate level of knowledge of the accounting and financial reporting practices of the entity may be obtained by the auditor auditing or reviewing, in accordance with GAAS, historical financial statements of the entity (or, in the case of a business combination, of a significant constituent part of the combined entity) for the most recent annual or interim period for which the pro forma financial information is presented.

.A59 Exhibit B, example D, "Comments on Pro Forma Financial Information," provides illustrations of wording regarding negative assurance on pro forma financial information as to compliance with the applicable accounting requirements of Rule 11-02 of Regulation S-X or with the pro forma bases as described in the pro forma financial information. Exhibit B, example O, provides an illustration of wording regarding procedures performed and findings obtained for pro forma financial information. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Financial Forecasts (Ref: par. .54–.57)

[.A60] [Paragraph deleted by the issuance of SAS No. 129, July 2014.]

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[17]Paragraph 3 of example A-1 in exhibit B.

[18]Paragraphs 4*b* and 5*b* of example L, "Alternate Wording When Recent Earnings Data Are Presented in Capsule Form," in exhibit B.

.A61 Exhibit B, example E, "Comments on a Financial Forecast," provides illustrations of appropriate wording describing procedures performed on a financial forecast.

.A62 The attestation standards that apply to financial forecasts provide for examinations of and agreed-upon procedures related to financial forecasts but not reviews. AR-C section 80A, *Compilation Engagements*, applies when reporting on the compilation of a financial forecast. If a compilation report on the financial forecast has been issued in connection with the comfort letter, the report need not be included in the securities offering. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

Subsequent Changes (Ref: par. .58–.64)

.A63 Comments regarding subsequent changes typically relate to whether, during the change period, there has been any

- change in capital stock;
- increase in long-term debt; or
- decreases in other specified financial statement items.

These comments might also address such matters as subsequent changes in the amounts of

- net current assets or stockholders' equity attributable to the entity.
- net sales and income from continuing operations and of net income or net income attributable to the entity. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A64 Procedures may include

- reading minutes and discussing with those charged with governance those meetings for which minutes have not been approved, and
- making inquiries of entity officials relating to the whole of the change period and obtaining appropriate written representations of the entity officials to support the answers to the inquiries.

.A65 Exhibit B, example A-1 provides an illustration of a description of procedures related to subsequent changes.[19]

.A66 Examples of the application of the requirements of paragraph .59 are as follows:

- When the auditor has audited the December 31, 20X0 financial statements, the auditor may provide negative assurance about changes in specified financial

[19]Paragraph 6 of example A-1 in exhibit B.

statement items as of any date through May 14, 20X1 (134 days subsequent to December 31).

- When the auditor has audited the December 31, 20X0 financial statements and has also conducted a review of the interim financial information as of and for the quarter ended March 31, 20X1, in accordance with GAAS applicable to reviews of interim financial information, the auditor may provide negative assurance about changes in specified financial statement items as of any date through August 12, 20X1 (134 days subsequent to March 31).

.A67 An appropriate manner of expressing negative assurance regarding subsequent changes is shown in exhibit B, in example A-1 if there has been no change, increase, or decrease, as applicable, and in example M, "Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item," if there has been a decrease.[20]Example M may be modified when auditors are aware of a change or increase. Exhibit B, example O provides an illustration of reporting procedures performed and findings obtained relating to the subsequent change period. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A68 In commenting on subsequent changes, the auditor may use terms such as *change*, *increase*, or *decrease*. Terms such as *adverse* are not clearly understood and may cause the comments on subsequent changes to be ambiguous.

.A69 The comparison for the change period relates to the entire period and not to portions of that period. A decrease during one part of the period may be offset by an equal or larger increase in another part of the period. Because no decrease for the period as a whole existed, the comfort letter would not report the decrease occurring during one part of the period. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A70 When more than one auditor is involved, the auditor of the group financial statements may comment that there were no decreases in the consolidated financial statement items, when appropriate, despite the possibility that decreases have been mentioned in a comfort letter issued by a component auditor. Exhibit B, example J, "Alternate Wording When Component Auditors Are Involved," contains an illustration of wording when more than one auditor is involved. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A71 The underwriting agreement usually specifies the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared. For balance sheet items, the comparison date is normally that of the latest balance sheet included in the securities offering (that is, immediately prior to the beginning of the change period). For income statement items, the comparison period or periods might be, but are not limited to, the corresponding period of the preceding year or a period of corresponding length immediately preceding the change period.

[20]Paragraphs 5*b* and 6 of example A-1 in exhibit B.

.A72 The reasons for identifying the date and period used for comparison are to avoid misunderstandings about the matters being compared, and so that the requesting party can determine whether the comparison period is suitable for the requesting party's purposes.

.A73 The requesting party might request that the change period begin immediately after the date of the latest audited balance sheet (which is, ordinarily, also the closing date of the latest audited statement of income) in the securities offering, even though the securities offering includes a more recent unaudited balance sheet and statement of income. The use of the earlier date may defeat the requesting party's purpose because it is possible that an increase in one of the items referred to in paragraph .A63 occurring between the dates of the latest audited and unaudited balance sheets included in the securities offering might more than offset a decrease occurring after the latter date. A similar situation might arise in the comparison of income statement items. In these circumstances, the decrease occurring after the date of the latest unaudited interim financial information included in the securities offering would not be reported in the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Tables, Statistics, and Other Financial Information (Ref: par. .65–.71)

.A74 Other financial information appearing in the securities offering does not include financial information that is covered by the auditor's opinion on the financial statements.

.A75 Because the term *presents fairly*, when used by independent auditors, ordinarily relates to presentations of financial statements, the use of the term in commenting on other types of information may be misleading.

.A76 When the auditor has conducted an examination or a review of MD&A in accordance with AT-C section 395, the auditor may agree to trace nonfinancial data presented outside MD&A to similar data included in the MD&A presentation. When the auditor does not perform a review or an examination of MD&A or does not attach or refer to a report on MD&A, the auditor may perform procedures agreed to with the requesting party with respect to items in MD&A subject to internal control over financial reporting. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A77 Options for describing the procedures performed and the findings obtained include

- describing them individually for each item of specific information commented on.
- grouping or summarizing some or all of the descriptions, as long as
  - — the procedures and findings are adequately described,
  - — the applicability of the descriptions to items in the securities offering is clear, and
  - — the descriptions do not imply that the auditor assumes responsibility for the adequacy of the procedures.
- presenting a matrix listing the financial information and common procedures employed and indicating the procedures applied to the specific items.

- identifying procedures performed with specified symbols and identifying items to which those procedures have been applied directly on a copy of the securities offering, which is attached to the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A78 Exhibit B, examples F, "Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings," G, "Comments on Tables, Statistics, and Other Financial Information—Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information," and H, "Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols," provide illustrations of appropriate ways of expressing comments on tables, statistics, and other financial information.

.A79 Except with respect to requirements for financial statements and certain Regulation S-K items discussed in paragraph .72, the question of what constitutes appropriate information for compliance with the requirements of a particular item of the securities offering form is a matter of legal interpretation outside the competence of auditors.

.A80 Exhibit B, example F contains an illustration of an appropriate way of stating the limitations regarding the sufficiency of the auditor's procedures.[21]

Compliance as to Form With Regulation S-K (Ref: par. .72–.73)

.A81 The following are the disclosure requirements of Regulation S-K that generally meet the criteria in paragraph .72:

- Item 301, "Selected Financial Data"
- Item 302, "Supplementary Financial Information"
- Item 402, "Executive Compensation"
- Item 503(d), "Ratio of Earnings to Fixed Charges"

.A82 Because information relevant to Regulation S-K disclosure requirements other than those noted previously is generally not derived from the accounting records subject to internal control over financial reporting, it is not appropriate for the auditor to comment on conformity of this information with Regulation S-K.

.A83 The auditor's inability to comment on conformity with Regulation S-K does not preclude the auditor from performing procedures and reporting findings with respect to this information.

.A84 Item 305, "Quantitative and Qualitative Disclosures About Market Risk," of Regulation S-K does not meet the criteria in paragraph .65 for the auditor to provide

[21] Paragraph 9 of example F, "Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings," in exhibit B.

comments on the Item 305 qualitative disclosures because the disclosures are not derived from the accounting records but are descriptive and hypothetical or forward-looking in nature.

.A85 Item 305 does not meet the criteria in paragraph .72 for the auditor to provide negative assurance on conformity with Item 305. Although some information needed to comply with Item 305 is derived from the accounting records, registrants must also provide a substantial amount of information that is not derived from accounting records subject to internal control over financial reporting.

.A86 Item 305 requires quantitative disclosures that may be presented in the form of a tabular presentation, sensitivity analysis, or value-at-risk disclosures. The auditor may perform limited procedures related to tabular presentations to the extent that such information is derived from the accounting records subject to internal control over financial reporting.

.A87 The appendix, "Commenting in a Comfort Letter on Quantitative Disclosures About Market Risk Made in Accordance With Item 305 of Regulation S-K," provides guidance on providing comments on Item 305 quantitative disclosures and examples of very simplified procedures, findings, and limitations related to Item 305 tabular presentation disclosures.

Concluding Paragraph (Ref: par. .74)

.A88 An illustration of an appropriate concluding paragraph is shown in exhibit B, examples A-1, A-2, and B.

Disclosure of Subsequently Discovered Matters (Ref: par. .75)

.A89 Subsequently discovered matters may include changes in specified items not disclosed in the securities offering, as discussed in paragraph .62.

.A90 The auditor's participation in the meeting may be helpful when the entity and requesting party discuss such matters.

Appendix — Commenting in a Comfort Letter on Quantitative Disclosures About Market Risk Made in Accordance With Item 305 of Regulation S-K

.A91

.A91-1 Regulation S-K, Item 305, Quantitative and Qualitative Disclosures About Market Risk, requires certain quantitative and qualitative disclosures with respect to derivative financial instruments, generally as defined in Financial Accounting Standards Board *Accounting Standards Codification* glossary.

.A91-2 In addition to qualitative (that is, descriptive) disclosures, Item 305 requires quantitative disclosures that may be presented in the form of a tabular presentation, sensitivity analysis, or value-at-risk disclosures. Disclosures generally include a combination of historical and fair value data and the hypothetical effects on such data of assumed changes in interest rates, foreign currency exchange rates, commodity prices, and other relevant market rates. The quantitative and qualitative information required by Item 305 are disclosed outside the financial statements and related notes thereto.

.A91-3 Item 305 does not meet the criteria in paragraph .65 for the auditor to provide comments on the Item 305 qualitative disclosures because the disclosures are descriptive and are not derived from the accounting records because they are hypothetical or forward-looking in nature.

.A91-4 Although some information needed to comply with Item 305 is derived from the accounting records, registrants must also provide a substantial amount of information that is not derived from accounting records subject to internal control over financial reporting. As a result, Item 305 does not meet the criteria in paragraph .72 for the auditor to provide negative assurance on conformity with Item 305 of Regulation S-K.

.A91-5 The three alternative forms of quantitative disclosures under Item 305 reflect hypothetical effects on market risk sensitive instruments and result in differing presentations. The forward-looking information used to prepare these presentations may be substantially removed from the accounting records that are subject to internal control over financial reporting. Further, paragraph .68 also states that the auditor should not comment on matters merely because the auditor is capable of reading, counting, measuring, or performing other functions that might be applicable. Accordingly, an auditor's ability to comment on these disclosures is largely dependent upon the degree to which the forward-looking information used to prepare these disclosures is linked to such accounting records.

.A91-6 The tabular presentation includes the fair values of market risk sensitive instruments and contract terms to determine the future cash flows from those instruments that are categorized by expected maturity dates. This approach may require the use of yield curves and implied forward rates to determine expected maturity dates, as well as assumptions regarding prepayments and weighted average interest rates.

.A91-7 The term *sensitivity analysis* describes a general class of models that are designed to assess the risk of loss in market risk sensitive instruments, based upon hypothetical changes in market rates or prices. Sensitivity analysis does not refer to any one, specific model and may include duration analysis or other "sensitivity" measures. The disclosures are dependent upon assumptions about theoretical future market conditions and, therefore, are not derived from the accounting records.

.A91-8 The term *value at risk* describes a general class of models that provide a probabilistic assessment of the risk of loss in market risk sensitive instruments over a selected period of time, with a selected likelihood of occurrences based upon selected confidence intervals. Value-at-risk disclosures are extremely aggregated and, in addition to the assumptions made for sensitivity analyses, may include additional assumptions regarding correlation between asset classes and future market volatilities. As a result, these disclosures are not derived from the accounting records.

.A91-9 Of the three disclosure alternatives, the tabular presentation contains the most limited number of assumptions and least complex mathematical calculations. Furthermore, certain information, such as contractual terms, included in a tabular presentation is derived from the accounting records. Accordingly, auditors may perform limited procedures related to tabular presentations to the extent that such information is derived from the accounting records subject to internal control over financial reporting.

.A91-10 The modeling techniques and underlying assumptions utilized for sensitivity analysis and value-at-risk disclosures generally will be highly complex. The resultant disclosures may be substantially different from the basic historical financial input derived directly from the accounting records. Due to the hypothetical and forward-looking nature of these disclosures and the potentially limited usefulness of any procedures that may be performed, sensitivity analysis or value-at-risk disclosures do not meet the criteria in paragraph .65 for the auditor to agree to make any comments or perform any procedures related to sensitivity analysis or value-at-risk disclosures.

.A91-11 When performing procedures related to tabular presentation disclosures, the auditor is required by paragraph .65 to consider whether the entity's documentation of its contractual positions in derivatives, commodities, and other financial instruments is subject to internal control over financial reporting and whether it provides a complete record of the entity's market risk sensitive instruments. In addition, the auditor is not permitted to express positive or negative assurance about the reasonableness of the assumptions underlying the disclosures.

.A91-12 Item 305 requires registrants to stratify financial instruments according to market risk category, that is, interest rate risk, foreign exchange risk, and equity price risk. Item 305 stipulates that if an instrument is at risk in more than one category, the instrument should be included in the disclosures for each applicable category. The stratifications and the company's determination of market risk categories are not derived from the company's accounting records. Accordingly, the auditor is not permitted to provide any findings that the company's stratifications are complete or comply as to form with Item 305 requirements and should disclaim with respect to the company's determination of market risk categories.

.A91-13 Item 305 encourages registrants to provide quantitative and qualitative information about market risk in terms of, among other things, the magnitude of actual past market movements and estimates of possible near-term market movements. As market data is not derived from the company's accounting records, the auditor is not permitted to agree to perform any procedures related to such market data.

.A91-14 Further, the auditor may need to utilize a specialist in performing procedures related to those disclosures.

.A91-15 The following examples, based on example H, "Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols," of exhibit B, "Examples of Comfort Letters," provide very simplified procedures, findings, and limitations related to Item 305 tabular presentation disclosures. In practice, the procedures generally will be substantially more complex.

Symbol	Procedures and Findings
√	Compared with a schedule prepared by the Company from its accounting records. We (*a*) compared the amounts on the schedule to corresponding amounts appearing in the accounting records and found such amounts to be in agreement, and (*b*) determined that the schedule was mathematically correct. However, we make no comment as to the appropriateness or completeness of the Company's classification of its market-risk-sensitive instruments into market risk categories, nor as to its determination of the expected maturity dates or amounts. (Note: This is an example of procedures related to tabular presentations of face amounts, carrying amounts, fair values, and notional amounts, which stratify such amounts as to interest rate risk.)
⊗	Compared with a schedule prepared by the Company from its accounting records to calculate weighted average fixed interest rates and weighted average fixed pay and receive rates and found such percentages to be in agreement. We (*a*) compared the amounts on the schedule to corresponding amounts appearing in the accounting records and found such amounts to be in agreement, and (*b*) determined that the schedule was mathematically correct. However, we make no comment as to the appropriateness of the Company's methodology in calculating weighted average fixed rates. (*Note*: It may be necessary to provide a more complete description of the procedures performed in other circumstances.) We make no comment as to the appropriateness or completeness of the Company's determination of the Regulation S-K requirements for quantitative and qualitative disclosures about market risks or with respect to the reasonableness of the assumptions underlying the disclosures.

[*The following is an extract from a registration statement that illustrates how an auditor can document procedures performed on a tabular presentation of market risk disclosures made in accordance with Item 305 of Regulation S-K.*]

INTEREST RATE SENSITIVITY

The following table provides information about the Company's derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including interest rate swaps and debt obligations. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates are based on implied forward rates in the yield curve at the reporting date. The information is presented in U.S. dollar equivalents, which is the Company's reporting currency. The instrument's actual cash flows are denominated in both U.S. dollars ($US) and German deutschmarks (DM), as indicated in parentheses.

	Expected maturity dates						
	20X2 *1*	20X3 *1*	20X4 *1*	20X5 *1*	There-after *1*	Total	Fair Value
Liabilities							
Long-Term Debt:			*($US equivalent in millions)*				
Fixed Rate ($US)	$XXX	$XXX	$XXX	$XXX	$XXX	$XXX√	$XXX√
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX%⊗	
Fixed Rate (DM)	XXX	XXX	XXX	XXX	XXX	XXX√	XXX√
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX%⊗	
Variable Rate ($US)	XXX	XXX	XXX	XXX	XXX	XXX√	XXX√
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX%*1*	
Interest Rate Derivatives			*($US equivalent in millions)*				
Interest Rate Swaps:							
Variable to fixed ($US)	$XXX	$XXX	$XXX	$XXX	$XXX	$XXX√	$XXX√
Average pay rate-fixed	XX%	XX%	XX%	XX%	XX%	XX%⊗	
Average receive rate-variable	XX%	XX%	XX%	XX%	XX%	XX%*1*	
Fixed to Variable ($US)	XXX	XXX	XXX	XXX	XXX	XXX√	XXX√
Average pay rate-variable	XX%	XX%	XX%	XX%	XX%	XX%*1*	
Average receive rate-fixed	XX%	XX%	XX%	XX%	XX%	XX%⊗	

1 Because these disclosures include either management's expectations of future cash flows or the use of implied forward rates applied to such expected cash flows, such information does not meet the criteria of paragraph .65. Accordingly, the auditor is not permitted to express findings on amounts in these columns.

Exhibit A — Illustration of Representation Letter From Requesting Party (Ref: par. .A4)

.A92

The following is an example of a letter from a nonunderwriter when the securities offering is not being registered under the Securities Act of 1933. If requested to provide a definition of substantially consistent, the following language may be added to the letter:

> What is substantially consistent may vary from situation to situation and may not be the same as that done in a registered offering of the same securities for the same entity. Whether the procedures being, or to be, followed will be substantially consistent is determined by us on a case-by-case basis.

[*Date*]

Dear ABC Accountants:

[*Name of requesting party*], as principal or agent, in the placement of [*identify securities*] to be issued by [*name of issuer of the securities*], will be reviewing certain information relating to [*issuer of the securities*] that will be included (incorporated by reference) in the document [*if appropriate, identify the document*], which may be delivered to investors and utilized by them as a basis for their investment decision. This review process, applied to the information relating to the issuer of the securities, is (will be) substantially consistent with the due diligence review process that an underwriter would perform if this placement [*issuance*] of securities were being registered pursuant to the Securities Act of 1933 (the Act). We are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Act. We hereby request that you deliver to us a "comfort" letter concerning the financial statements of the issuer of the securities and certain statistical and other data included in the offering document. We will contact you to identify the procedures we wish you to follow and the form we wish the comfort letter to take.

Very truly yours,

[*Name of Requesting Party*]

[As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Exhibit B — Examples of Comfort Letters

.A93

Example A — Typical Comfort Letters **.A93-3–.A93-4**

Example A-1 — Typical Comfort Letter for a 1933 Act Offering **.A93-3**

Example A-2 — Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained **.A93-4**

Example B — Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference **.A93-5**

Example C — Letter Reaffirming Comments as of a Later Date **.A93-6**

Example D — Comments on Pro Forma Financial Information **.A93-7–.A93-8**

Example D-1 — Negative Assurance on Pro Forma Financial Information as to Compliance With The Applicable Accounting Requirements of Rule 11-02 of Regulation S-X **.A93-7**

Example D-2 — Negative Assurance on Pro Forma Financial Information as to Compliance With Pro Forma Bases as Described in the Pro Forma Financial Information **.A93-8**

Example E — Comments on a Financial Forecast **.A93-9**

Example F — Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings **.A93-10**

Example G — Comments on Tables, Statistics, and Other Financial Information—Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information **.A93-11**

Example H — Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols **.A93-12**

Example I — Alternate Wording When Auditor's Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph **A.93-13**

Example J — Alternate Wording When Component Auditors Are Involved **.A93-14**

Example K — Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements **.A93-15**

Example L — Alternate Wording When Recent Earnings Data Are Presented in Capsule Form **.A93-16**

Example M — Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item **.A93-17**

Example N — Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a 12-Month Period **.A93-18**

Example O — Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing Standards Applicable to Reviews of Interim Financial Information **.A93-19**

Example P — Intentionally Omitted (See example A-2)

Example Q — Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11 **.A93-20**

Example R — Alternate Wording When Reference to Examination of Annual Management's Discussion and Analysis and Review of Interim Management's Discussion and Analysis Is Made **.A93-21**

Introduction

.A93-1 The contents of comfort letters vary depending on the extent of the information in the securities offering and the wishes of the requesting party. Shelf registration statements may have several closing dates and different underwriters. Descriptions of procedures and findings regarding interim financial information, tables, statistics, or other financial information that is incorporated by reference from previous Securities Exchange Act of 1934 filings may have to be repeated in several comfort letters. To avoid restating these descriptions in each comfort letter, the auditor may initially issue the comments in a format (such as an appendix) that can be referred to in, and attached to, subsequently issued comfort letters.

.A93-2 A typical comfort letter includes

a. a statement regarding the independence of the auditor. (Ref: par. .35)

b. if applicable, an opinion regarding whether the audited financial statements included (incorporated by reference) in the securities offering comply as to form in all material respects with the applicable accounting requirements of the Securities Act of 1933 (the 1933 Act) and related rules and regulations adopted by the Securities and Exchange Commission (SEC). (Ref: par. .36–.40)

c. negative assurance on whether

   i. if applicable, the unaudited interim financial information included (incorporated by reference) in the securities offering (Ref: par. .45–.48) complies as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.

   ii. any material modifications should be made to the unaudited interim financial information included (incorporated by reference) in the securities offering for them to be in conformity with the applicable financial reporting framework.

d. negative assurance on whether, during a specified period following the date of the latest financial statements in the securities offering, there has been any change in capital stock, increase in long-term debt, or any decrease in other specified financial statement items. (Ref: par. .58–.64)

Example A-1 contains a typical comfort letter for a 1933 Act offering and example A-2 contains a typical comfort letter for a non-1933 Act offering. Letters that cover some of the items may be developed by omitting inapplicable portions of these examples. Examples B, D–O, and R contain additional or alternate wording for examples A-1 or A-2, as applicable, for various scenarios.

Although the illustrations in this exhibit describe procedures that may be followed by auditors as a basis for their comments, this section does not necessarily prescribe such procedures.

Example A — Typical Comfort Letters

Example A-1 — Typical Comfort Letter for a 1933 Act Offering

.A93-3 Example A-1 is an example of a letter that the auditor of a nonissuer may provide when a registrant is including the nonissuer's financial statements in a securities offering to be filed with the SEC. Appropriate modifications would be made if additional financial information is covered by the comfort letter. Example A-1 assumes the following circumstances:

- The prospectus includes audited consolidated balance sheets as of December 31, 20X5 and 20X4, and audited consolidated statements of income, stockholders' equity, and cash flows for each year in the three-year period ended December 31, 20X5. Note that the example assumes all the net income is attributable to the company. If that were not the case, the references to net income would be modified, or additional references would be included as appropriate.

- The prospectus also includes an unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, reviewed in accordance with generally accepted auditing standards applicable to reviews of interim financial information; however the review report is not included in the securities offering. If the review report is included in the securities offering, the auditor may state that the auditor has issued a review report on the interim financial information in the introductory paragraph of the comfort letter, as follows:

> Also, we have reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5, as indicated in our report dated May 15, 20X6, which is included (incorporated by reference) in the registration statement.

The cut-off date is June 23, 20X6, and the letter is dated June 28, 20X6. The effective date is June 28, 20X6.

- The auditors are reporting independence under the SEC rules and regulations. If the auditors were not required to be independent under the SEC rules and regulations in conjunction with an SEC filing, paragraph 1 in example A-1 would be replaced with paragraph 1 in example A-2.

The auditor may agree to comment in the comfort letter on whether the interim financial information complies as to form in all material respects with the applicable accounting requirements of the rules and regulations adopted by the SEC.

The example also assumes that there has been no change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in paragraph 5 of example A-1.

Each of the comments in the letter is in response to a requirement of the underwriting agreement. For purposes of example A-1, the income statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 28, 20X6

[*Addressee*]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in The Issuer Company's (the registrant) registration statement (no. 33-00000) on Form S-1 filed by the registrant under the Securities Act of 1933 (the Act); our report with respect thereto is also included in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement.

In connection with the registration statement—

1. We are independent certified public accountants with respect to the company within the meaning of the 1933 Act and the applicable rules and regulations thereunder adopted by the SEC.
2. In our opinion [*include the phrase* except as disclosed in the registration statement *if applicable*], the consolidated financial statements audited by us and included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.
3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registration statement, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.
4. For purposes of this letter we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

   i. Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registration statement.

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a*(i) comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—

   i. Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, officials of the company having advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. [*If applicable:* The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statements of cash flows and other disclosures.]

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited consolidated financial information referred to in *b*(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the registration statement.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a. i. Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4*a*(i), included in the registration statement, for them to be in conformity with generally accepted accounting principles.[1]

[1]Section 930, *Interim Financial Information*, does not require the auditor to modify the report on a review of interim financial information for a lack of consistency in the application of accounting policies provided that the interim financial information appropriately discloses such matters.

ii. The unaudited condensed consolidated financial statements described in 4*a*(i) do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. i. At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the registration statement, or

ii. for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared to the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the registration statement discloses have occurred or may occur.

6. As mentioned in 4*b*, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (*a*) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6, unaudited condensed consolidated balance sheet included in the registration statement, or (*b*) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the registration statement discloses have occurred or may occur.

7. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example A-2 — Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained

.A93-4 Example A-2 is applicable when a comfort letter is issued in a non-1933 Act offering. Example A-2 assumes the following:

The cut-off date is June 23, 20X6, and the letter is dated June 28, 20X6.

- The offerer is not an SEC registrant.
- The requesting party has given the auditor a representation letter as required by paragraph .11 and illustrated in paragraph .A92.
- The securities offering includes audited consolidated balance sheets as of December 31, 20X5 and 20X4, and audited consolidated statements of income, stockholders' equity, and cash flows for each year in the three-year period ended December 31, 20X5. Note that the example assumes all the net income is attributable to the company. If that were not the case, the references to net income would be modified, or additional references would be included as appropriate.
- The securities offering also includes an unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, reviewed in accordance with generally accepted auditing standards applicable to reviews of interim financial information; however, the review report is not included in the securities offering. If the review report is included in the securities offering, the auditor may state that the auditor has issued a review report on the interim financial information. in the introductory paragraph of the comfort letter, as follows:

> Also, we have reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5, as indicated in our report dated May 15, 20X6, which is included (incorporated by reference) in the securities offering.

- The auditor did not perform an audit of the effectiveness of internal control over financial reporting in any period.
- There has not been a change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in paragraph 4.

Each of the comments in the letter is in response to a request from the requesting party. For purposes of example A-2, the income statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 28, 20X6

[*Addressee*]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included [*or incorporated by reference*] in the offering memorandum for $30,000,000 of Senior Debt due May 30, 20Z6. Our report with respect thereto is included in the offering memorandum. This offering memorandum, dated June 28, 20X6, is herein referred to as the Offering Memorandum.

This letter is being furnished in reliance upon your representation to us that—

a. You are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Securities Act of 1933 (the Act).

b. In connection with the offering of Senior Debt, the review process you have performed is substantially consistent with the due diligence review process that you would have performed if this placement of securities were being registered pursuant to the Act.

In connection with the Offering Memorandum—

1. We are independent certified public accountants with respect to the company under the “Independence Rule” of the AICPA's Code of Professional Conduct and its interpretations.

2. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, of cash flows, and of changes in stockholders’ equity for the three-month periods ended March 31, 20X5 and 20X6, included in the Offering Memorandum, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.

3. For purposes of this letter, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such

meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

   i. Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum.

b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—

   i. Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, officials of the company having advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. [*If applicable:* The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statement of cash flows and other disclosures.]

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited consolidated financial information referred to in *b*(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

4. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a. i. Any material modifications should be made to the unaudited condensed consolidated financial statements described in 3*a*(i), included in the Offering Memorandum, for them to be in conformity with generally accepted accounting principles.[2]

b. i. At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or decrease in consolidated net current assets

[2]Section 930 does not require the auditor to modify the report on a review of interim financial information for a lack of consistency in the application of accounting policies provided that the interim financial information appropriately discloses such matters.

or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or

ii. for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared to the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the Offering Memorandum discloses have occurred or may occur.

5. As mentioned in 3*b*, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6 are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 3. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (*a*) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or (*b*) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 3, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the Offering Memorandum discloses have occurred or may occur.

6. This letter is solely for the information of the addressees and to assist the requesting party in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the Offering Memorandum, and it is not to be used, circulated, quoted, or otherwise referred to for any purpose, including but not limited to the purchase or sale of securities, nor is it to be filed with or referred to in whole or in part in the Offering Memorandum or any other document, except that reference may be made to it in the Purchase Contract or in any list of closing documents pertaining to the offering of the securities covered by the Offering Memorandum.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example B — Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference

.A93-5 Example B is an example of modifications to the letter that the auditor of a nonissuer may provide when a registrant has acquired the nonissuer, and the registrant uses a short-form registration statement (for example, Form S-3), which incorporates a previously filed Form 8-K that includes the nonpublic company's financial statements. The auditor was independent of the nonissuer but is not independent with respect to the registrant.

June 28, 20X6

[*Addressee*]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in The Issuer Company's (the registrant) current report on Form 8-K dated May 15, 20X6, and incorporated by reference in the registration statement (no. 33-00000) on Form S-3 filed by the registrant under the Securities Act of 1933 (the Act); our report with respect thereto is also incorporated by reference in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement.

In connection with the registration statement—

1. As of [*insert date of the auditor's most recent report on the financial statements of the entity*] and during the period covered by the financial statements on which we reported, we were independent certified public accountants with respect to the company under the "Independence Rule" of the AICPA's Code of Professional Conduct and its interpretations.

2. In our opinion, the consolidated financial statements audited by us and incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.

3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the consolidated financial statements for any interim period within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registrant's current report on Form 8-K dated May 15, 20X6, incorporated by reference in the registration statement, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.

4. For purposes of this letter, we have read the 20X6 minutes of the meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such

meetings through that date were set forth therein, and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

i. Performed a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registrant's current report on Form 8-K dated May 15, 20X6, incorporated by reference in the registration statement.

ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in (i) comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations about the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

   i. Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4(i), incorporated by reference in the registration statement, for them to be in conformity with generally accepted accounting principles.

   ii. The unaudited condensed consolidated financial statements described in 4(i) do not comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.

6. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and for use of the auditors of the registrant in furnishing their letter to the underwriters, and it is not to be used, circulated, quoted, or otherwise referred to within the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or any list of closing

documents pertaining to the offering of the securities covered by the registration statement.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example C — Letter Reaffirming Comments as of a Later Date

.A93-6 If more than one comfort letter is requested, the subsequent letter may, in appropriate situations, refer to information appearing in the earlier letter without repeating such information (see paragraph .25 of this section and paragraph .A93-1 of this exhibit). Example C reaffirms and updates the information in example A-1. In a non-1933 Act offering, the last paragraph in example C would be replaced with the last paragraph in example A-2.

July 25, 20X6

[*Addressee*]

Dear Ladies and Gentlemen:

We refer to our letter of June 28, 20X6, relating to the registration statement (no. 33-00000) of The Nonissuer Company, Inc. (the company). We reaffirm as of the date hereof (and as though made on the date hereof) all statements made in that letter except that, for the purposes of this letter

a. The registration statement to which this letter relates is as amended on July 13, 20X6 [*effective date*].

b. The reading of minutes described in paragraph 4 of that letter has been carried out through July 20, 20X6 [*the new cut-off date*].

c. The procedures and inquiries covered in paragraph 4 of that letter were carried out to July 20, 20X6 [*the new cut-off date*] (our work did not extend to the period from July 21, 20X6 to July 25, 20X6 [*date of letter*], inclusive).

d. The period covered in paragraph 4*b* of that letter is changed to the period from April 1, 20X6 to June 30, 20X6, officials of the company having advised us that no financial statements as of any date or for any period subsequent to June 30, 20X6, were available.

e. The references to May 31, 20X6 in paragraph 5*b* of that letter are changed to June 30, 20X6.

f. The references to May 31, 20X6 and June 23, 20X6 in paragraph 6 of that letter are changed to June 30, 20X6 and July 20, 20X6, respectively.

This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example D — Comments on Pro Forma Financial Information

Example D-1 — Negative Assurance on Pro Forma Financial Information as to Compliance With The Applicable Accounting Requirements of Rule 11-02 of Regulation S-X

.A93-7 Example D-1 is applicable when the auditor is asked to provide negative assurance on (*a*) whether the pro forma financial information included in a securities offering complies as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X, and (*b*) the application of pro forma adjustments to historical amounts in the compilation of the pro forma financial information (see paragraphs .52–.53). The material in this example is intended to be inserted between paragraphs 6 and 7 in example A-1 or between paragraphs 5 and 6 in example A-2. The example assumes that the auditor has not previously reported on the pro forma financial information. If the auditor did previously report on the pro forma financial information, the auditor may refer in the introductory paragraph of the comfort letter to the fact that the auditor has issued a report, and the report may be attached to the comfort letter (see paragraphs .A31–.A32). In that circumstance, the procedures in 7*b*(i) and 7*c* ordinarily would not be performed, and therefore the auditor would not separately comment on the application of pro forma adjustments to historical financial information because that assurance is encompassed in the auditor's report on pro forma financial information. The auditor may, however, agree to comment on compliance as to form with the applicable accounting requirements of Rule 11-02 of Regulation S-X.

7. At your request, we have—

   a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the [*registration statement or* Offering Memorandum*, as applicable*].

   b. Inquired of certain officials of the company who have responsibility for financial and accounting matters about

      i. the basis for their determination of the pro forma adjustments and

      ii. whether the unaudited pro forma condensed consolidated financial statements referred to in 7*a* comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X.

   c. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

The foregoing procedures are substantially less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes.

8. Nothing came to our attention as a result of the procedures specified in paragraph 7, however, that caused us to believe that the unaudited pro forma condensed consolidated financial statements referred to in 7*a* included in the [*registration statement or* Offering Memorandum*, as applicable*] do not comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X and that the pro forma adjustments have not been properly applied to the historical amounts in the compilation of the unaudited pro forma condensed consolidated financial statements. Had we performed additional procedures or had we made an examination or review of the pro forma condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

Example D-2 — Negative Assurance on Pro Forma Financial Information as to Compliance With Pro Forma Bases as Described in the Pro Forma Financial Information

.A93-8 Example D-2 is applicable when the auditor is asked to provide negative assurance on (*a*) whether the pro forma financial information included in a securities offering complies as to form in all material respects with the pro forma bases described in the pro forma financial statements, and (*b*) the application of pro forma adjustments to historical amounts in the compilation of the pro forma financial information (see paragraphs .52–.53). The material in this example is intended to be inserted between paragraphs 5 and 6 in example A-2.

The example assumes that the auditor has not previously reported on the pro forma financial information. If the auditor did previously report on the pro forma financial information, the auditor may refer in the introductory paragraph of the comfort letter to the fact that the auditor has issued a report, and the report may be attached to the comfort letter (see paragraphs .A31–.A32). In that circumstance, the procedures in 6*b*(i) and 6*c* ordinarily would not be performed, and therefore the auditor would not separately comment on the application of pro forma adjustments to historical financial information because that assurance is encompassed in the auditor's report on pro forma financial information. The auditor may, however, agree to comment on compliance as to form with the pro forma bases described in the pro forma financial statements.

6. At your request, we have—

a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the Offering Memorandum.

b. Inquired of certain officials of the company who have responsibility for financial and accounting matters about

   i. the basis for their determination of the pro forma adjustments, and

   ii. whether the unaudited pro forma condensed consolidated financial statements referred to in 6*a* comply as to form in all material respects with the pro forma bases described in the pro forma condensed consolidated financial statements.

c. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

The foregoing procedures are substantially less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes.

7. Nothing came to our attention as a result of the procedures specified in paragraph 6, however, that caused us to believe that the unaudited pro forma condensed consolidated financial statements referred to in 6*a* included in the Offering Memorandum do not comply in all material respects with the pro forma bases described in the pro forma condensed consolidated financial statements and that the pro forma adjustments have not been properly applied to the historical amounts in the compilation of the unaudited pro forma condensed consolidated financial statements. Had we performed additional procedures or had we made an examination or a review of the pro forma condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

Example E — Comments on a Financial Forecast

.A93-9 Example E is applicable when an auditor is asked to comment on a financial forecast (see paragraph .54). The material in this example is intended to be inserted between paragraphs 6 and 7 in example A-1 or between paragraphs 5 and 6 in example A-2. The example assumes that the auditor has previously reported on the compilation of the financial forecast and that the report is attached to the letter (see paragraphs .A31–.A32).

7. At your request, we performed the following procedure with respect to the forecasted consolidated balance sheet and consolidated statements of income and cash flows as of December 31, 20X6, and for the year then ending. With respect to forecasted rental income, we compared the occupancy statistics about expected demand for rental of the housing units to statistics for existing comparable properties and found them to be the same.

8. Because the procedure described above does not constitute an examination of prospective financial statements in accordance with standards promulgated by the American Institute of Certified Public Accountants, we do not express an opinion on whether the prospective financial statements are presented in conformity with AICPA presentation guidelines or on whether the underlying assumptions provide a reasonable basis for the presentation.

Had we performed additional procedures or had we made an examination of the forecast in accordance with standards promulgated by the AICPA, matters might have come to our attention that would have been reported to you. Furthermore, there will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.

Example F — Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings

.A93-10 Example F is applicable when the auditor is asked to comment on tables, statistics, or other compilations of information appearing in a securities offering (paragraphs .65–.71). Each of the comments is in response to a specific request. The paragraphs in example F are intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2. In a non-1933 Act securities offering, paragraph 9*c*(iii) generally would not be included.

In some cases, the auditor may choose to combine in one paragraph the substance of paragraphs 7 and 9 shown as follows. This may be done by expanding the identification of items in paragraph 9 to provide the identification information included in paragraph 7. In such cases, the introductory sentences in paragraphs 7 and 9 and the text of paragraph 8 might be combined as follows: "For purposes of this letter, we have also read the following information and have performed the additional procedures stated below with respect to such information. Our audit of the consolidated financial statements. . ."

7. For purposes of this letter, we have also read the following, set forth in the [*registration statement or* Offering Memorandum, *as applicable*] securities offering on the indicated pages.

Item	Page	Description
a	4	"Capitalization." The amounts under the captions "Amount Outstanding as of May 31, 20X6" and "As Adjusted." The related notes, except the following in Note 2: "See Transactions With Interested Persons." From the proceeds of this offering the company intends to prepay $900,000 on these notes, pro rata. See "Use of Proceeds."
b	13	"History and Business—Sales and Marketing." The table following the first paragraph.
c	33	"Selected Financial Data."

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, or any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter, we have performed the following additional procedures, which were applied as indicated with respect to the items enumerated above.

Item in 7	Procedures and Findings
a	We compared the amounts and numbers of shares listed under the caption, "Amount Outstanding as of May 31, 20X6," with the balances in the appropriate accounts in the company's general ledger and found them to be in agreement. We compared the amounts and numbers of shares listed under the caption, "Amount Outstanding as of May 31, 20X6," adjusted for the issuance of the debentures to be offered by means of the securities offering and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption, "As Adjusted," and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of the "Use of Proceeds" or whether such use will actually take place.)
b	We compared the amounts of military sales, commercial sales, and total sales shown in the securities offering with the balances in the appropriate accounts in the company's accounting records for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. We proved the arithmetic accuracy of the percentages of such amounts of military sales and commercial sales to total sales for the respective fis-

Item in 7	Procedures and Findings
	cal years and for the unaudited interim periods. We compared such computed percentages with the corresponding percentages appearing in the [*registration statement or* Offering Memorandum*, as applicable*] and found them to be in agreement.
c	i. We compared the amounts of net sales and income from continuing operations for the years ended December 31, 20X5, 20X4, and 20X3, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts for the years ended December 31, 20X2 and 20X1, with the respective amounts in the consolidated financial statements for 20X2 and 20X1 and found them to be in agreement. ii. We compared the amounts of total assets, long-term obligations, and redeemable preferred stock at December 31, 20X5 and 20X4, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts at December 31, 20X3, 20X2, and 20X1, with the corresponding amounts in the consolidated financial statements for 20X3, 20X2, and 20X1 and found them to be in agreement. iii. We compared the information included under the heading "Selected Financial Data" with the disclosure requirements of Item 301 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Item 301 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 301 of Regulation S-K.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [*registration statement or* Offering Memorandum*, as applicable*] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

Example G — Comments on Tables, Statistics, and Other Financial Information — Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information

.A93-11 Example G illustrates, in paragraph 8*a*, a method of summarizing the descriptions of procedures and findings regarding tables, statistics, and other financial information in order to avoid repetition in the comfort letter. Each of the comments is in response to a specific request. The paragraphs in example G are intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2. In a non-1933 Act securities offering, paragraph 9*a*(ii) generally would not be included.

Other methods of summarizing the descriptions may also be appropriately used. For example, the letter may present a matrix listing the financial information and common procedures employed and indicating the procedures applied to specific items.

7. For purposes of this letter, we have also read the following, set forth in the [*registration statement or* Offering Memorandum*, as applicable*] on the indicated pages.

Item	Page	Description
a	4	"Capitalization." The amounts under the captions "Amount Outstanding as of May 31, 20X6" and "As Adjusted." The related notes, except the following in Note 2: "See Transactions With Interested Persons." From the proceeds of this offering the company intends to prepay $900,000 on these notes, pro rata. See "Use of Proceeds."
b	13	"History and Business—Sales and Marketing." The table following the first paragraph.
c	33	"Selected Financial Data."

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, or any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter and with respect to the items enumerated in 7 above—

a. i. Except for item 7*a*, we have (i) compared the dollar amounts either with the amounts in the audited consolidated financial statements described in the introductory paragraph of this letter or, for prior years, included in the company's accounting records, or with amounts in the unaudited consolidated financial statements described in paragraph 3 to the extent such amounts are included in or can be derived from such statements and found them to be in agreement; (ii) compared the amounts of military sales, commercial sales, and total sales with amounts in the company's accounting records and found them to be in agreement; (iii) compared other dollar amounts with amounts shown in analyses prepared by the company and found them to be in agreement; and (iv) proved the arithmetic accuracy of the percentages based on the data in the above-mentioned financial statements, accounting records, and analyses.

ii. We compared the information in item 6*c* with the disclosure requirements of Item 301 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Item 301 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 301 of Regulation S-K.

b. With respect to item 7*a*, we compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of May 31, 20X6" with the balances in the appropriate accounts in the company's general ledger at May 31, 20X6, and found them to be in agreement. We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of May 31, 20X6," adjusted for the issuance of the debentures to be offered by means of the securities offering and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption, "As Adjusted" and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of "Use of Proceeds" or whether such use will actually take place.)

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [*registration statement or* Offering Memorandum*, as applicable*] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

Example H — Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols

.A93-12 This example illustrates an alternate format, which could facilitate reporting when the auditor is requested to perform procedures on numerous statistics included in a securities offering. Each of the comments is in response to a specific request. The paragraph in example H is intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2.

7. For purposes of this letter, we have also read the items identified by you on the attached copy of the [*registration statement or* Offering Memorandum*, as applicable*] and have performed the following procedures, which were applied as indicated with respect to the symbols explained below:

✓ Compared the amount with The Nonissuer Company, Inc.'s financial statements for the period indicated included in the securities offering and found them to be in agreement.

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, nor any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.

9. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [*registration statement or* Offering Memorandum*, as applicable*] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

[*The following is an extract from a securities offering that illustrates how an auditor can document procedures performed on numerous statistics included in the securities offering.*]

Summary Financial Information of The Nonissuer Company, Inc. (In thousands)

	The Nonissuer Company, Inc. Year Ended December 31,		
Income statement data	**20X3**	**20X4**	**20X5**
Revenue from home sales	$104,110✓	$115,837✓	$131,032✓
Gross profit from sales	23,774✓	17,099✓	22,407✓
Income from home building net of tax	7,029✓	1,000✓	3,425✓

Example I — Alternate Wording When Auditor's Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph

.A93-13 Example I is applicable when the auditor's report on the audited financial statements included in the securities offering contains an emphasis-of-matter paragraph regarding a matter that would also affect the unaudited condensed consolidated interim financial information included in the securities offering. The introductory paragraph would be revised as follows:

Our report with respect thereto (which contains an emphasis-of-matter paragraph that describes a lawsuit to which the company is a defendant, discussed in note 8 to the consolidated financial statements), is also included in the [*registration statement or* Offering Memorandum*, as applicable*].

The matter described in the emphasis-of-matter paragraph would also be evaluated to determine whether it also requires mention in the comments on the unaudited condensed consolidated interim financial information (paragraph 5*b* of example A-1 and paragraph 4*b* of example A-2). If it is concluded that mention of such a matter in the comments on unaudited condensed consolidated financial information is appropriate, a sentence would be added at the end of paragraph 5*b* in example A-1 and paragraph 4*b* of example A-2 as follows:

Reference should be made to the introductory paragraph of this letter, which states that our audit report covering the consolidated financial statements as of and for the year ended December 31, 20X5, includes an emphasis-of-matter paragraph that describes a lawsuit to which the company is a defendant, discussed in note 8 to the consolidated financial statements.

Example J — Alternate Wording When Component Auditors Are Involved

.A93-14 Example J applies when one or more component auditors are involved in the audit of group financial statements, and the group engagement team has obtained a copy of the comfort letter of the component auditors (see paragraph .21). Example J consists of an addition to paragraph 4, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A-1 and corresponding changes to paragraphs 3, 4, and 5 of example A-2, respectively.

[4]*c*. We have read the letter dated _________ of [*the other auditors*] with regard to [*the related company*].

5. Nothing came to our attention as a result of the foregoing procedures (which, so far as [*the related company*] is concerned, consisted solely of reading the letter referred to in 4*c*), however, that caused us to believe that...

6. …On the basis of these inquiries and our reading of the minutes and the letter dated ________ of [*the other auditors*] with regard to [*the related company*], as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [*registration statement or* Offering Memorandum*, as applicable*] discloses have occurred or may occur.

Example K — Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements

.A93-15 Example K is applicable when (*a*) there is a departure from the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC, and (*b*) representatives of the SEC have agreed to the departure. Paragraph 2 of example A-1 would be revised to read as follows:

2. In our opinion [*include the phrase* except as disclosed in the registration statement *if applicable*], the consolidated financial statements and financial statement schedules audited by us and included (incorporated by reference) in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC; however, as agreed to by representatives of the SEC, statements of assets acquired and liabilities assumed and statements of revenues and direct operating expenses of The Nonissuer Company, Inc. have been presented in lieu of separate financial statements required by Rule 3-05 of Regulation S-X.

Example L — Alternate Wording When Recent Earnings Data Are Presented in Capsule Form

.A93-16 Example L is applicable when (*a*) the statement of income in the securities offering is supplemented by later information regarding sales and earnings (capsule financial information), (*b*) the auditor is asked to comment on that information (paragraphs .49–.51), and (*c*) the auditor has conducted a review in accordance with generally accepted auditing standards applicable to reviews of interim financial information of the financial statements from which the capsule financial information is derived. The same facts exist as in example A-1, or for a non-1933 Act filing as in example A-2, except for the following:

- Sales and net income (no extraordinary items) for the six-month periods ended June 30, 20X6 and 20X5 (both unaudited), are included in capsule form more limited than that specified by Financial Accounting Standards Board *Accounting Standards Codification* 270, *Interim Reporting*.
- No financial statements later than those for June 20X6 are available.
- The letter is dated July 25, 20X6, and the cut-off date is July 20, 20X6.

Paragraphs 4, 5, and 6 of example A-1, or paragraphs 3, 4 and 5 of example A-2, would be revised to read as follows; in a non-1933 Act securities offering, paragraphs 4*a*(ii) and 5*a*(ii) generally would not be included:

4. For purposes of this letter, we have read the 20X6 minutes of the meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at July 20, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to July 20, 20X6, as follows (our work did not extend to the period from July 21, 20X6 to July 25, 20X6, inclusive):

a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

   i. Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the [*registration statement or* Offering Memorandum*, as applicable*].

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a*(i) comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. With respect to the six-month periods ended June 30, 20X6 and 20X5, we have—

   i. Read the unaudited amounts for sales and net income for the six-month periods ended June 30, 20X6 and 20X5, as set forth in paragraph [*identify location*].

   ii. Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of June 30, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the six-month periods ended June 30, 20X6 and 20X5, from which the unaudited amounts referred to in *b*(i) are derived.

   iii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited amounts referred to in *b*(i) are stated on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a. i. Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4*a*(i), included in the [*registration statement or* Offering Memorandum*, as applicable*], for them to be in conformity with generally accepted accounting principles.

ii. The unaudited condensed consolidated financial statements described in 4*a*(i) do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. i. The unaudited amounts for sales and net income for the six-month periods ended June 30, 20X6 and 20X5, referred to in 4*b*(i) do not agree with the amounts set forth in the unaudited condensed consolidated financial statements for those same periods.

ii. The unaudited amounts referred to in 4*b*(i) were not determined on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

c. At June 30, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum*, as applicable*], except in all instances for changes, increases, or decreases that the [*registration statement or* Offering Memorandum*, as applicable*] discloses have occurred or may occur.

6. Company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to June 30, 20X6 are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after June 30, 20X6 have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (*a*) at July 20, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum*, as applicable*]; or (*b*) for the period from July 1, 20X6 to July 20, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [*registration statement or* Offering Memorandum*, as applicable*] discloses have occurred or may occur.

Example M — Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item

.A93-17 Example M covers a situation in which auditors are aware of a decrease in a financial statement item on which they are requested to comment (see paragraphs .58–.64). Example M may be modified when auditors are aware of a change or increase. The same facts exist as in example A-1 or example A-2, as applicable, except for the decrease covered in the following change in paragraph 5*b* in example A-1 or paragraph 4*b* in example A-2:

b.

i. At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum*, as applicable*], or

ii. for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the [*registration statement or* Offering Memorandum*, as applicable*] discloses have occurred or may occur and except that the unaudited consolidated balance sheet as of May 31, 20X6, which we were furnished by the company, showed a decrease from March 31, 20X6, in consolidated net current assets as follows (in thousands of dollars):

	Current Assets	Current Liabilities	Net Current Assets
March 31, 20X6	$4,251	$1,356	$2,895
May 31, 20X6	3,986	1,732	2,254

6. As mentioned in 4*b*, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (*a*) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum*, as applicable*]; or (*b*) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [*registration statement or* Offering Memorandum*, as applicable*] discloses have occurred or may occur and except as described in the following sentence: We have been informed by officials of the company that there continues to be a decrease in net current assets that is estimated to be approximately the same amount as set forth in 5*b* [*or whatever other disclosure fits the circumstances*].

Example N — Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a 12-Month Period

.A93-18 Certain types of companies are permitted to include earnings data for a 12-month period to the date of the latest balance sheet furnished in lieu of earnings data for both the interim period between the end of the latest fiscal year and the date of the latest balance sheet and the corresponding period of the preceding fiscal year. The following would be substituted for the applicable part of paragraph 3 of example A-1:

> 3. …was to enable us to express our opinion on the financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any period included in part within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the related unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the 12 months then ended included in the registration statement.

Example O — Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing Standards Applicable to Reviews of Interim Financial Information

.A93-19 The example assumes that the requesting party has asked the auditor to perform specified procedures on the interim financial information and report thereon in the comfort letter. The letter is dated June 28, 20X6; procedures were performed through June 23, 20X6, the cut-off date. Because a review in accordance with generally accepted auditing standards applicable to reviews of interim financial information was not performed on the interim financial information as of March 31, 20X6, and for the quarter then ended, the auditor is limited to reporting procedures performed and findings obtained on the interim financial information.

The following would be substituted for paragraphs 4–6 of example A-1 or paragraphs 3–5 of example A-2. In a non-1933 Act securities offering, the two statements in paragraph 4(a)(ii) with respect to compliance as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC, would not be included. Example O assumes there has not been a change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in subparagraph *a*(ii) that follows:

4. For purposes of this letter, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

   i. Read the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the [*registration statement or* Offering Memorandum*, as applicable*], and agreed the amounts included therein with the company's accounting records as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5.

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a*(i): (1) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the [*registration statement or* Offering Memorandum*, as applicable*], and (2) comply as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC. Those officials stated that the unaudited condensed consolidated financial statements (1) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements, and (2) comply as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—

   i. Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, and agreed the amounts contained therein to the company's accounting records. Officials of the company have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. [*If applicable:* The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statements of cash flows and other disclosures.]

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether (1) the unaudited consolidated financial information referred to in b(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the [*registration statement or* Offering Memorandum*, as applicable*]; (2)

at May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum, *as applicable*]; and (3) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

Those officials stated that (1) the unaudited consolidated financial information referred to in 4*b*(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the [*registration statement or* Offering Memorandum, *as applicable*]; (2) at May 31, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decrease in net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum, *as applicable*]; and (3) there were no decreases for the period from April 1, 20X6 to May 31, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

c. As mentioned in 4*b*(i), company officials have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4*a* and 4*b*. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or* Offering Memorandum, *as applicable*], or (b) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. Those officials stated that (1) at June 23, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet, and (2) for the period from April 1, 20X6 to June 23, 20X6, there were no decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

The foregoing procedures do not constitute an audit or a review conducted in accordance with generally accepted auditing standards. We make no representations regarding the sufficiency of the foregoing procedures for your purposes. Had we performed additional procedures or had we conducted an audit or a review of the company's March 31, April 30, or

May 31, 20X6 and 20X5 condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

5. At your request, we also—

a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the [*registration statement or* Offering Memorandum*, as applicable*].

b. Inquired of certain officials of the company and of XYZ Company (the company being acquired) who have responsibility for financial and accounting matters as to whether all significant assumptions regarding the business combination had been reflected in the pro forma adjustments and whether the unaudited pro forma condensed consolidated financial statements referred to in (a) comply as to form in all material respects with the [*applicable accounting requirements of Rule 11-02 of Regulation S-X or pro forma bases described in the pro forma condensed consolidated financial statements, as applicable*].

   Those officials referred to above stated, in response to our inquiries, that all significant assumptions regarding the business combination had been reflected in the pro forma adjustments and that the unaudited pro forma condensed consolidated financial statements referred to in (a) comply as to form in all material respects with the [*applicable accounting requirements of Rule 11-02 of Regulation S-X or pro forma bases described in the pro forma condensed consolidated financial statements, as applicable*].

c. Compared the historical financial information for the company included on page 20 in the [*registration statement or* Offering Memorandum*, as applicable*] with historical financial information for the company on page 12 and found them to be in agreement.

   We also compared the financial information included on page 20 of the [*registration statement or* Offering Memorandum*, as applicable*] with the historical information for XYZ Company on page 13 and found them to be in agreement.

d. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

   The foregoing procedures are less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. We make no representation about the sufficiency of the foregoing procedures for your purposes. Had we performed additional procedures or had we made an examination or review of the pro forma financial information, other matters might have come to our attention that would have been reported to you.

Example P — Intentionally Omitted (See example A-2)[3]

Example Q — Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11

.A93-20 This example illustrates the letter to be provided in accordance with paragraph .11 in which the auditor does not provide negative assurance. This example assumes that these procedures are being performed at the request of the placement agent on information included in an offering memorandum in connection with a private placement of unsecured notes. The letter is dated June 30, 20X6; procedures were performed through June 25, 20X6, the cut-off date. The statements in paragraphs 4–8 of the example are illustrative of the statements required to be included by paragraph .12.

This example may also be used in connection with a filing under the 1933 Act when a party other than a named underwriter (for example, a selling shareholder) has not provided the auditor with the representation letter described in paragraph .11. In such a situation, this example may be modified to include the auditor's comments on independence and compliance as to form of the audited financial statements and financial statements schedules with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC. Paragraph 1*a*(ii) may include an inquiry, and the response of company officials, on compliance as to form of the unaudited condensed interim financial information.

[3]Example P, "A Typical Comfort Letter in a Non-1933 Act Offering, Including the Required Underwriter Representations," in AU section 634, *Letters for Underwriters and Certain Other Requesting Parties*, was moved to example A-2, "Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained," in this section when AU section 634 was redrafted for clarity, and is intentionally blank to retain the letters assigned to the other examples.

June 30, 20X6

[*Addressee*]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in the offering memorandum for $30,000,000 of notes due June 30, 20Z6. Our report with respect thereto is included in the offering memorandum. The offering memorandum dated June 30, 20X6, is herein referred to as the Offering Memorandum.

We are independent certified public accountants with respect to the company under the "Independence Rule" of the AICPA's Code of Professional Conduct and its interpretations.

We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.

1. At your request, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company as set forth in the minute books at June 25, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 25, 20X6, as follows (our work did not extend to the period from June 26, 20X6 to June 30, 20X6, inclusive):
    a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
        i. Read the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows of the company for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum, and agreed the amounts included therein with the company's accounting records as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5.

ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a*(i) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum. Those officials stated that the unaudited condensed consolidated financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements.

b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—

   i. Read the unaudited condensed consolidated financial information of the company for April and May of both 20X5 and 20X6, furnished us by the company, and agreed the amounts included therein with the company's accounting records. Officials of the company have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. [*if applicable:* The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statements of cash flows and other disclosures.]

   ii. Inquired of certain officials of the company who have responsibility for financial and accounting matters whether (1) the unaudited condensed consolidated financial information referred to in *b*(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum; (2) at May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum; and (3) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.
   Those officials stated that (1) the unaudited condensed consolidated financial information referred to in *b*(ii) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum; (2) at May 31, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum; and (3) there were no decreases for the period from April 1, 20X6 to May 31, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

c. As mentioned in 1*b*, company officials have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 1*a* and 1*b*. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (i) at June 25, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or (ii) for the period from April 1, 20X6 to June 25, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

   Those officials referred to above stated that (i) at June 25, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6, unaudited condensed consolidated balance sheet, and (ii) there were no decreases for the period from April 1, 20X6 to June 25, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

2. For purposes of this letter, we have also read the items identified by you on the attached copy of the Offering Memorandum and have performed the following procedures, which were applied as indicated with respect to the symbols explained below:

   Compared the amount with the company's financial statements for the period indicated and found them to be in agreement.

   Compared the amount with the company's financial statements for the period indicated included in the Offering Memorandum and found them to be in agreement.

   Compared with a schedule or report prepared by the company and found them to be in agreement.

3. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, nor for any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.

4. It should be understood that we have no responsibility for establishing (and did not establish) the scope and nature of the procedures enumerated in paragraphs 1–3 above; rather, the procedures enumerated therein are those the requesting party asked us to perform. Accordingly, we make no representations regarding questions of

legal interpretation[4] or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraphs; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above as set forth in the Offering Memorandum. Further, we have addressed ourselves solely to the foregoing data and make no representations regarding the adequacy of disclosures or whether any material facts have been omitted. This letter relates only to the financial statement items specified above and does not extend to any financial statement of the company as a whole.

5. The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Had we performed additional procedures or had we conducted an audit or a review of the company's March 31, April 30, or May 31, 20X6 and 20X5 condensed consolidated financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you.

6. These procedures should not be taken to supplant any additional inquiries or procedures that you would undertake in your consideration of the proposed offering.

7. This letter is solely for your information and to assist you in your inquiries in connection with the offering of the securities covered by the Offering Memorandum, and it is not to be used, circulated, quoted, or otherwise referred to for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the Offering Memorandum or any other document, except that reference may be made to it in any list of closing documents pertaining to the offering of the securities covered by the offering document.

8. We have no responsibility to update this letter for events and circumstances occurring after June 25, 20X6.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example R — Alternate Wording When Reference to Examination of Annual Management's Discussion and Analysis and Review of Interim Management's Discussion and Analysis Is Made

.A93-21 This example is applicable when the auditor is making reference to an examination of annual MD&A and a review of interim MD&A. The same facts exist as in example A-1, except for the following:

[4]Paragraph .A6 of this section.

- The auditor has examined the company's Management's Discussion and Analysis (MD&A) for the year ended December 31, 20X5, in accordance with AT-C section 395, *Management's Discussion and Analysis*.
- The auditor has also performed reviews of the company's unaudited condensed consolidated financial statements in accordance with generally accepted auditing standards applicable to reviews of interim financial information and the company's MD&A for the three-month period ended March 31, 20X6, in accordance with AT-C section 395.
- The accountant's reports on the examination and review of MD&A have been previously issued, but not distributed publicly; none of these reports is included in the securities offering. In this example, the auditor has elected to attach the previously issued reports to the comfort letter (see paragraph .A32).

Appropriate modifications would be made to the opening paragraph of the comfort letter if the auditor has performed a review of the company's annual MD&A.

The following would be substituted for the first paragraph of example A-1.

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, the related notes to the consolidated financial statements, and the related financial statement schedules, all included in The Issuer Company's (the registrant) registration statement (no. 33-00000) on Form S-1 filed by the registrant under the Securities Act of 1933 (the Act); our reports with respect thereto are also included in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement. Also, we have examined the company's Management's Discussion and Analysis (MD&A) for the year ended December 31, 20X5, included in the registration statement, as indicated in our report dated March 28, 20X6; our report with respect thereto is attached. We have also reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6 and 20X5, and for the three-month periods then ended, included in the registration statement, as indicated in our report dated May 15, 20X6, and have also reviewed the company's MD&A for the three-month period ended March 31, 20X6, included in the registration statement, as indicated in our report dated May 15, 20X6; our reports with respect thereto are attached.

The following paragraph would be added after paragraph 3 of example A-1:

4. We have not examined any MD&A of the company as of or for any period subsequent to December 31, 20X5; although we have made an examination of the company's MD&A for the year ended December 31, 20X5, included in the registration statement, the purpose (and, therefore, the scope) of the examination was to enable us to express our opinion on such MD&A, but not on the MD&A for any interim period within that year. Therefore, we are unable to and do not express any opinion on the MD&A for the three-month period ended March 31, 20X6, included in the registration statement, or for any period subsequent to March 31, 20X6.

[As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

AU-C Section 925

Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933

Source: SAS No. 122; SAS No. 133.

Effective for filings under the Securities Act of 1933 that include audited financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section (Ref: par. .A1)

.01 This section addresses the auditor's responsibilities in connection with financial statements of a nonissuer included or incorporated by reference in a registration statement filed with the U.S. Securities and Exchange Commission (SEC) under the Securities Act of 1933, as amended. Exhibit A, "Background," provides background information on certain liability provisions of Section 11 of the Securities Act of 1933, including Section 11(b)(3)(B).

Effective Date

.02 This section is effective for filings under the Securities Act of 1933 that include audited financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor, in connection with audited financial statements of a nonissuer that are separately included or incorporated by reference in a registration statement filed under the Securities Act of 1933, is to perform specified procedures at or shortly before the effective date of the registration statement to sustain the burden of proof that the auditor has performed a reasonable investigation, as referred to in Section 11(b)(3)(B) of the Securities Act of 1933.

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Auditor's consent. A statement signed and dated by the auditor that indicates that the auditor consents to the use of the auditor's report, and other references to the auditor, in a registration statement filed under the Securities Act of 1933.

Awareness letter. A letter signed and dated by the auditor to acknowledge the auditor's awareness that the auditor's review report on unaudited interim financial information is being used in a registration statement filed under the Securities Act of 1933. This letter is not considered to be part of the registration statement and is also commonly referred to as an *acknowledgment letter*.

Effective date of the registration statement. The date on which the registration statement filed under the Securities Act of 1933 becomes effective for purposes of evaluating the auditor's liability under Section 11 of the Securities Act of 1933. (Ref: par. .A2 and .A14)

.05 References to *included* or *the inclusion of* in a registration statement in this section means *included* or *incorporated by reference* in a registration statement filed under the Securities Act of 1933.

Requirements

Effective Date of the Registration Statement (Ref: par. .A3)

.06 Because the effective date of a registration statement filed under the Securities Act of 1933 may not necessarily coincide with the filing date, the auditor should request management to keep the auditor advised of the progress of the registration proceedings through the effective date of the registration statement.

The Prospectus and Other Information (Ref: par. .A4–.A8)

.07 When the auditor's report on audited financial statements is included in a registration statement filed under the Securities Act of 1933, the auditor should perform the procedures described in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, on the prospectus and pertinent portions of the registration statement (including material that is incorporated by reference). [Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

.08 In connection with the procedures required by paragraph .07, the auditor should determine that the auditor's name is not being used in a way that indicates that the auditor's responsibility is greater than the auditor intends.

Subsequent Events Procedures (Ref: par. .A9–.A11)

.09 When the most recent separate financial statements of the entity and related auditor's report are included in the registration statement, the auditor should perform the following procedures described in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or shortly before the effective date of the registration statement:[1]

a. Audit procedures designed to identify events occurring between the date of the auditor's report and the effective date of the registration statement that require adjustment to, or disclosure in, the financial statements. Such procedures, which take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, should include

[1]Paragraphs .09–.10 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

  i. obtaining an understanding of any procedures that management has established to ensure that such events are identified.

  ii. inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements.

  iii. reading minutes, if any, of the meetings of the entity's owners, management, and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

  iv. reading the entity's latest subsequent interim financial statements, if any.

b. Obtain updated written representations from management at or shortly before the effective date of the registration statement, about whether

  i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified.

  ii. any events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements.

.10 When the auditor has audited the most recent period for which separate audited financial statements of the entity are included in the registration statement and

a. the entity has been acquired by another entity,

b. the acquirer's audited financial statements included in the registration statement reflect a period that includes the date of acquisition, and

c. the auditor is a predecessor auditor because the auditor is not the continuing auditor of the entity,

the auditor may be unable to perform all of the procedures in paragraph .09. In such circumstances, the auditor should obtain written representations from management and the successor auditor as described in section 560 at or shortly before the effective date of the registration statement.[2]

.11 If a predecessor auditor audited the entity's separate financial statements for a prior period included in the registration statement but has not audited the entity's separate financial statements for the most recent audited period for which the entity's audited financial statements are included in the registration statement, then the predecessor auditor should perform the following procedures described in section 560 through a date at or shortly before the effective date of the registration statement:[3]

[2]Paragraph .19*c–d* of section 560.

[3]Paragraph .19 of section 560.

a. Read the financial statements of the subsequent period to be presented on a comparative basis

b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis

c. Obtain written representations from management at or shortly before the effective date

d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor

.12 If the auditor becomes aware of subsequently discovered facts, the auditor should not provide the auditor's consent until the auditor's consideration of subsequently discovered facts, including the effect on the auditor's report on the financial statements, has been satisfactorily completed in accordance with section 560.[4] If management does not revise the audited financial statements in circumstances in which the auditor believes they need to be revised, then the auditor should determine whether to withhold the auditor's consent (and the awareness letter, if applicable). (Ref: par. .A11)

Unaudited Annual Financial Statements or Unaudited Interim Financial Information

.13 If the auditor concludes, based on known facts, that unaudited annual financial statements or unaudited interim financial information included in a registration statement filed under the Securities Act of 1933 is not in conformity with the requirements of the applicable financial reporting framework, then the auditor should request that management revise the unaudited annual financial statements or unaudited interim financial information appropriately.

.14 If management does not revise the unaudited annual financial statements or unaudited interim financial information appropriately and

a. the auditor has reported on a review of the unaudited annual financial statements or unaudited interim financial information,

b. the auditor's review report is included in the registration statement, and

c. the subsequently discovered facts are such that they would have affected the report had they been known to the auditor at the date of the report,

the auditor should perform the applicable procedures described in section 560.[5]

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[4]Paragraphs .15–.18 of section 560.

[5]Paragraphs .14 and .17–.18 of section 560.

.15 If management does not revise the unaudited annual financial statements or unaudited interim financial information appropriately and

a. the auditor has not reported on a review of the unaudited annual financial statements or unaudited interim financial information or

b. the auditor's review report is not included in the registration statement,

the auditor should modify the report on the audited financial statements to describe the departure from the requirements of the applicable financial reporting framework contained in the unaudited annual financial statements or unaudited interim financial information, as described in section 930, *Interim Financial Information*.[6]

.16 Additionally, the auditor should determine whether to withhold the auditor's consent (and the awareness letter, if applicable). (Ref: par. .A11)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 This section is written from the perspective of a registration statement filed under the Securities Act of 1933. The liability provisions under the Securities Act of 1933 differ from those (Section 10[b] and Rule 10[b][5], in particular) under the Securities Exchange Act of 1934.

Definitions

Effective Date of the Registration Statement (Ref: par. .04)

.A2 Exhibit A describes the process commonly referred to as *shelf registration*. Exhibit A also provides additional guidance about the effective date of a registration statement, including situations in which a posteffective amendment is made or a prospectus supplement is filed.[7] Both of these situations may create a new effective date. Exhibit A also discusses the auditor's liability under Section 11 of the Securities Act of 1933 with regard to these situations.

Effective Date of the Registration Statement (Ref: par. .06)

.A3 Requesting management to keep the auditor advised of the progress of the registration proceedings through the effective date is important so that the auditor's consideration of events occurring after the date of the auditor's report up to the effective date, or as close thereto as reasonable and practicable, can be completed by the effective date of the registration statement. Generally, the filing date of a registration statement will precede the effective date. In addition to performing the procedures required by this section at or shortly

[6] Paragraph .35 of section 930, *Interim Financial Information*.

[7] Paragraphs 8–12 of exhibit A, "Background."

before the effective date, the auditor may also perform some or all of the procedures in this section at or shortly before the filing date.

The Prospectus and Other Information (Ref: par. .07–.08)

.A4 The reading of the entire prospectus (including any supplemental prospectuses and documents incorporated by reference—such as forms 10-K, 10-Q, and 8-K) assists the auditor in fulfilling the auditor's statutory responsibilities to perform a reasonable investigation, as described in Section 11(c) of the Securities Act of 1933.

References to the Auditor as an Expert in Connection With a Securities Act of 1933 Registration Statement

.A5 The requirements in paragraphs .07–.08 assist the auditor in determining that the references to the auditor in the Securities Act of 1933 registration statement are appropriate. For example, management's disclosure in the "experts" section cannot imply that the financial statements have been prepared by the auditor or that the financial statements are not the direct representations of management.

.A6 The SEC does not require an entity to include an auditor's review report on unaudited interim financial information in the registration statement unless the registration statement states that the unaudited interim financial information has been reviewed by an independent auditor. If the registration statement includes the auditor's review report on interim financial information, then the requirements in paragraphs .07–.08 assist the auditor in determining that the issuer discloses the fact that an interim review report is not a report on, or a part of, the registration statement prepared or certified by the auditor, within the meaning of Section 7 and Section 11 of the Securities Act of 1933, and that the auditor's liability under Section 11 does not extend to the auditor's review report.

.A7 The auditor is not considered an expert with respect to the auditor's review report on interim financial information and, therefore, it is important that this fact is clearly described. For example, the disclosures relating to the auditor's report on the audited financial statements may be included under a heading titled "Experts," and the disclosures in paragraph .A6 would then be included under a heading titled "Independent Auditors." Alternatively, the disclosures described in paragraph .A6 may be included under an "experts" section together with language stating the fact that an interim review report is not a report on, or a part of, the registration statement prepared or certified by the auditor, within the meaning of Section 7 and Section 11 of the Securities Act of 1933, and that the auditor's liability under Section 11 does not extend to the auditor's review report.

.A8 Exhibit A describes the disclosures relating to the auditor's report on the audited financial statements. Exhibit B, "Illustrative Disclosures and Reports," provides an illustration of this disclosure.

Subsequent Events Procedures (Ref: par. .09–.12)

.A9 An example of the conditions described in paragraphs .09–.11 would be a situation in which an issuer recently acquired a nonissuer that is considered significant to the issuer based on quantitative thresholds specified in the SEC's rules and regulations. In this case, the issuer's registration statement may need to include the separate audited financial statements of the acquired nonissuer for one or more periods.

.A10 In addition to the procedures required by paragraph .09, the auditor may consider it necessary and appropriate to inquire of, or extend previous oral or written inquiries to, the entity's legal counsel concerning litigation, claims, and assessments, as described in section 501, *Audit Evidence—Specific Considerations for Selected Items*.

.A11 In making the determination whether to withhold the auditor's consent, the auditor may consider it appropriate to obtain legal advice. (Ref: par. .12 and .16)

Exhibits

.A12 Exhibit A provides detailed background guidance on the following: (Ref: par. .04)

- The liability provisions of Section 11 of the Securities Act of 1933
- The auditor's consent and awareness letter
- The effective date of the registration statement
- References to the auditor as an expert in connection with a Securities Act of 1933 registration statement
- References to the auditor as an expert in a document other than a Securities Act of 1933 registration statement
- Letters similar to a consent prepared in connection with a document that is not a Securities Act of 1933 registration statement

.A13 Exhibit B provides illustrative disclosures and reports.

Exhibit A — Background

.A14

Exhibit A is intended to provide limited background information only.

Exhibit A is not intended to be, and does not constitute, a comprehensive or complete discussion of the liability provisions of the Securities Act of 1933, as amended. Exhibit A is not legal advice and reading it as such is inappropriate. Auditors are advised to consult with their legal counsel regarding the information provided in Exhibit A and the entire content of Section 11 of the Securities Act of 1933.

1. When an auditor's report is included in a registration statement filed under the Securities Act of 1933, the auditor's responsibility, generally, is in substance no different from that involved in other types of reporting. However, the nature and extent of this responsibility are specified in some detail in the applicable statutes and the related rules and regulations.

Liability Provisions of Section 11 of the Securities Act of 1933

2. Liability under the Securities Act of 1933 is defined in several sections of that act. One important section for auditors is Section 11.

3. Section 11(a) imposes civil liability on a number of parties that are involved in a registration statement filed under the Securities Act of 1933. One of the parties specifically mentioned in Section 11(a) is an auditor who has consented to the use of the auditor's report on audited financial statements in connection with a registration statement filed under the Securities Act of 1933 (Section 11[a][4]).

4. Section 11(b)(3)(B) of the Securities Act of 1933 provides that the auditor is not liable under Section 11(a) if the auditor

> sustain[s] the burden of proof . . . that . . . as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert.

5. Section 11(c) of the Securities Act of 1933 indicates that for the purpose of determining what constitutes reasonable investigation and reasonable ground to believe, "the standard of reasonableness shall be that required of a prudent man in the management of his own property."

Auditor's Consent and Awareness Letter

6. Section 7 of the Securities Act of 1933 requires an issuer to provide the consent of any auditor whose report on audited financial statements is included in a Securities Act of 1933 registration statement. The issuer's responsibility to file the auditor's consent is further discussed in Rule 436 of the Securities Act of 1933.

7. Rule 436(c) of the Securities Act of 1933 indicates that an auditor's report based on a review of interim financial information is not a report within the meaning of Section 11. Thus, the auditor does not have a similar statutory responsibility for such reports as of the effective date of the registration statement. Accordingly, the auditor's consent would not refer to the auditor's report on interim financial statements. However, the issuer is required to file an awareness letter from an auditor if the auditor's review report on interim financial information is included in a registration statement filed under the Securities Act of 1933.

Effective Date of the Registration Statement

8. The information in a registration statement filed under the Securities Act of 1933 is evaluated as of its effective date. Accordingly, the auditor who has consented to the inclusion of the auditor's report on audited financial statements in such a registration statement has a statutory responsibility that is determined in light of the circumstances on that date. The effective date for purposes of evaluating liability under Section 11 may be different for different parties. For instance, the effective date for determining liability under Section 11 for the issuer or for an underwriter may be later than the effective date for determining Section 11 liability for the auditor.

9. Certain Securities Act of 1933 rules and forms (for example, Rule 415 and Form S-3) permit issuers to register offerings of securities to be offered and sold on a delayed or continuous basis. This process is commonly referred to as *shelf registration*.

10. The prospectus included in a shelf registration statement at the time it becomes effective is commonly referred to as a *base prospectus*. Many issuers follow a "bare bones" approach to preparing the base prospectus by relying entirely on the documents incorporated by reference (for example, forms 10-K, 10-Q, and 8-K) to provide most, if not all, of the issuer-related disclosures. The base prospectus also generally omits information relating to the specific amount of each security to be offered and pricing information. That information is typically provided through a prospectus supplement filed pursuant to Rule 424(b) of the Securities Act of 1933 at the time the securities are sold (commonly referred to as *taken off the shelf* or a *shelf takedown*).

11. At the time of filing a shelf registration statement, the issuer undertakes to update the prospectus for a number of items. The issuer's undertakings are set forth in Item 512 of Regulation S-K. Information omitted from the base prospectus, as well as the information that the issuer has undertaken to provide at a later date, may be conveyed to investors

- by a posteffective amendment to the registration statement,

- by a prospectus supplement filed pursuant to Rule 424(b) of the Securities Act of 1933, or
- through the incorporation by reference of the information from a report filed under the Securities Exchange Act of 1934 (for example, Form 10-K or Form 8-K).

12. As previously discussed, liability under Section 11 of the Securities Act of 1933 is assessed based on the information included in the registration statement as of its effective date. As also previously noted, the effective date for purposes of evaluating liability under Section 11 as it relates to the auditor may differ from the effective date as it relates to other parties (for example, the issuer or any underwriters). From the auditor's perspective, the effective date in connection with a Securities Act of 1933 registration statement is the latest of the following:

- The date the original registration statement (for example, on Form S-3) becomes effective
- The effective date of any posteffective amendment
- The filing date of a prospectus supplement if the filing of the prospectus supplement creates a new effective date for the auditor (for example, the prospectus supplement may contain new or revised audited financial statements or other information about which the auditor is an expert and for which a new consent is required, as described in Rule 430B[f][3] of the Securities Act of 1933)
- The filing date of any report (for example, under the Securities Exchange Act of 1934) that includes or amends audited financial statements and is incorporated by reference into the already effective registration statement

For example, assume an issuer with an already effective shelf registration statement on Form S-3 acquires a private company, and the issuer is required to file the acquired company's audited financial statements pursuant to the requirements of Form 8-K. In this case, the issuer will be required to file an auditor's consent from the acquired company's auditor as an exhibit to Form 8-K. The guidance in this section is applicable to the acquired company's auditor in connection with providing the auditor's consent to the issuer.

References to the Auditor as an Expert in Connection With a Securities Act of 1933 Registration Statement

13. Although not required, most Securities Act of 1933 registration statements relating to underwritten offerings contain a section titled "Experts." This section can be defined as management's disclosure in a Securities Act of 1933 registration statement that states that audited financial statements are included in the registration statement in reliance upon the auditor's report on the audited financial statements. The "experts" section also typically indicates that the auditor's report on the audited financial statements has been given on the auditor's authority as an expert in accounting and auditing.

14. Exhibit B, "Illustrative Disclosures and Reports," provides an example of a typical "experts" section.

15. As with all sections of the registration statement, the disclosures in the "experts" section are the issuer's responsibility. However, Rule 436(b) of the Securities Act of 1933 requires the issuer to file an auditor's consent to being named as an expert.

References to the Auditor as an Expert in a Document Other Than a Securities Act of 1933 Registration Statement

16. The term *expert* has a specific statutory meaning under the Securities Act of 1933. Outside the Securities Act of 1933 context, the term *expert* is typically undefined. Accordingly, except as described in paragraph 18 of this exhibit, when an issuer wishes to make reference to the auditor's role in an offering document in connection with a securities offering that is not registered under the Securities Act of 1933, the caption to that section of the document would generally be titled "Independent Auditors" (or something similar) rather than "Experts," with no reference to the auditor as an expert anywhere in the document.

17. There may be situations in which the term *expert* is sufficiently defined such that the auditor may agree to be referred to as an expert outside the context of a registration statement filed under the Securities Act of 1933. For example, if the term *expert* is defined under applicable state law, the auditor may agree to be named as an expert in an offering document in an intrastate securities offering. An understanding of any auditor liability provisions that may be included in the applicable federal or state statutes is an important consideration. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

Letters Similar to Consents Prepared in Connection With a Document That Is Not a Securities Act of 1933 Registration Statement

18. When an auditor's report is used in connection with an offering transaction that is not registered under the Securities Act of 1933, it is not usually necessary for the auditor to provide any type of written consent. If the auditor is asked to provide a written consent for use in connection with a document other than a Securities Act of 1933 registration statement, then the auditor may provide a letter indicating that the auditor agrees to the inclusion of the auditor's report on the audited financial statements in the offering materials. Section 945 addresses the auditor's responsibilities when an auditor is involved with an exempt offering document.

[As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

Exhibit B — Illustrative Disclosures and Reports

.A15

The following is an example of a typical "experts" section in a registration statement filed under the Securities Act of 1933:

Experts

The consolidated balance sheets of Company X as of December 31, 20X2 and 20X1, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, included in this prospectus, have been so included in reliance on the report of ABC & Co, independent auditors, given on the authority of that firm as experts in auditing and accounting.

The following is an example of a disclosure for a registration statement filed under the Securities Act of 1933 that includes the auditor's review report on unaudited interim financial information when such disclosure is included in a separate section. This disclosure may also be included under a section titled "Experts":

Independent Auditors

With respect to the unaudited interim financial information of Company X for the three-month periods ended March 31, 20X3 and 20X2, included in this prospectus, ABC & Co. has reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated May XX, 20X3, included herein, states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. ABC & Co. is not subject to the liability provisions of section 11 of the Securities Act of 1933 for their report on the unaudited interim financial information because that report is not a "report" or a "part" of the registration statement prepared or certified by the accountants within the meaning of Sections 7 and 11 of the Act.

[As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

AU-C Section 930

Interim Financial Information

Source: SAS No. 122; SAS No. 132; SAS No. 135; SAS No. 140; SAS No. 145.

Effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2025, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when engaged to review interim financial information under the conditions specified in this section. The term *auditor* is used throughout this section, not because the auditor is performing an audit but because the scope of this section is limited to a review of interim financial information performed by an auditor of the financial statements of the entity.

.02 This section applies to a review of interim financial information when

a. the entity's latest annual financial statements have been audited by the auditor or a predecessor auditor;

b. the auditor either

   i. has been engaged to audit the entity's current year financial statements or

   ii. audited the entity's latest annual financial statements, and in situations in which it is expected that the current year financial statements will be audited, the engagement of another auditor to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; (Ref: par. .A1)

c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements; and

d. all of the following conditions are met if the interim financial information is condensed:

   i. The condensed interim financial information purports to be prepared in accordance with an appropriate financial reporting framework, which includes appropriate form and content of interim financial information. (Ref: par. .A2)

   ii. The condensed interim financial information includes a note that the financial information does not represent complete financial statements and is to be read in conjunction with the entity's latest audited annual financial statements.

   iii. The condensed interim financial information accompanies the entity's latest audited annual financial statements, or such audited annual financial statements are made readily available by the entity. (Ref: par. .A3)

Statements on Standards for Accounting and Review Services provide guidance for review engagements for which this section is not applicable.

.03 An auditor may find this section, adapted as necessary in the circumstances, useful when that auditor has not been engaged to perform a review of interim financial information but has nonetheless decided to perform review procedures on such financial information (for example, in connection with the inclusion of the auditor's report on the annual financial statements in an unregistered securities offering document).

Effective Date

.04 This section is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012.

Objective

.05 The objective of the auditor when performing an engagement to review interim financial information is to obtain a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework through performing limited procedures. (Ref: par. .A4–.A5)

Definition

.06 For purposes of this section, the following term has the meaning attributed as follows:

Interim financial information. Financial information prepared and presented in accordance with an applicable financial reporting framework that comprises either a complete or condensed set of financial statements covering a period or periods less than one full year or covering a 12-month period ending on a date other than the entity's fiscal year end.

Requirements

Acceptance

.07 Before accepting an engagement to review an entity's interim financial information for a new client, the auditor should follow the procedures for initial engagements required by section 210A, *Terms of Engagement*.[1]

.08 Before accepting an engagement to perform a review of interim financial information, the auditor should

a. determine whether the financial reporting framework to be applied in the preparation of the interim financial information is acceptable and

b. obtain the agreement of management that it acknowledges and understands its responsibility

  i. for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework;

  ii. for the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework;

  iii. to provide the auditor with

    1. access to all information of which management is aware that is relevant to the preparation and fair presentation of the interim financial information, such as records, documentation, and other matters;

    2. additional information that the auditor may request from management for the purpose of the review; and

[1]Paragraphs .11–.12 of section 210A, *Terms of Engagement*.

3. unrestricted access to persons within the entity of whom the auditor determines it necessary to make inquiries;[2] and

iv. to include the auditor's review report in any document containing interim financial information that indicates that such information has been reviewed by the entity's auditor.

.09 The auditor should not accept an engagement to review interim financial information if

a. the auditor has determined that the financial reporting framework to be applied in the preparation of the interim financial information is unacceptable.

b. the agreement referred to in paragraph .08*b* has not been obtained.

Agreement on Engagement Terms

.10 The auditor should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be recorded in an engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A6)

a. The objectives and scope of the engagement

b. The responsibilities of management set forth in paragraph .08*b*

c. The responsibilities of the auditor

d. The limitations of a review engagement

e. Identification of the applicable financial reporting framework for the preparation of the interim financial information

Procedures for a Review of Interim Financial Information

Understanding the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control

.11 To plan and conduct the engagement, the auditor should have an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control as it relates to the preparation and fair presentation of both annual and interim financial information, sufficient to be able to

a. identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.

b. select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that

[2]Paragraph .06 of section 210A.

should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.

[As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2023, by SAS No. 145.]

.12 To update or, in the case of an auditor who has not yet performed an audit of the entity's annual financial statements, obtain the understanding required by paragraph .11, the auditor should perform the following procedures: (Ref: par. .A7–.A8)

a. Read available documentation of the preceding year's audit and of reviews of the prior interim period(s) of the current year and the corresponding interim period(s) of the prior year to the extent necessary, based on the auditor's judgment, to enable the auditor to identify matters that may affect the current period interim financial information. In reading such documents, the auditor should specifically consider the nature of any (Ref: par. .A9–.A10)

   i. corrected material misstatements;

   ii. matters identified in any summary of uncorrected misstatements;

   iii. identified risks of material misstatement due to fraud, including the risk of management override of controls; and

   iv. significant financial accounting and reporting matters that may be of continuing significance, such as significant deficiencies and material weaknesses.

b. Read the most recent annual and comparable prior interim period financial information.

c. Consider the results of any audit procedures performed with respect to the current year's financial statements.

d. Inquire of management about changes in the entity's business activities.

e. Inquire of management about the identity of, and nature of transactions with, related parties.

f. Inquire of management about whether significant changes in internal control, as it relates to the preparation and fair presentation of interim financial information, have occurred subsequent to the preceding annual audit or prior review of interim financial information, including changes in the entity's policies, procedures, and personnel, as well as the nature and extent of such changes.

Analytical Procedures, Inquiries, and Other Review Procedures

Analytical Procedures

.13 The auditor should apply analytical procedures to the interim financial information to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Such analytical procedures should include the following: (Ref: par. .A11–.A13)

a. Comparing the interim financial information with comparable information for the immediately preceding interim period, if applicable, and with the corresponding period(s) in the previous year, giving consideration to knowledge about changes in the entity's business and specific transactions

b. Considering plausible relationships among both financial and, when relevant, nonfinancial information (Ref: par. .A14)

c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the auditor through identifying and using relationships that are reasonably expected to exist, based on the auditor's understanding of the entity and the industry in which the entity operates

d. Comparing disaggregated revenue data (Ref: par. .A15)

Inquiries and Other Review Procedures

.14 The auditor should make the following inquiries and perform the following other review procedures when conducting a review of interim financial information:

a. Read the available minutes of meetings of stockholders, directors, and appropriate committees and inquire about matters dealt with at meetings for which minutes are not available to identify matters that may affect the interim financial information. (Ref: par. .A16)

b. Obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued. (Ref: par. .A17)

c. Inquire of management about

   i. whether the interim financial information has been prepared and fairly presented in accordance with the applicable financial reporting framework consistently applied.

   ii. unusual or complex situations that may have an effect on the interim financial information. (Ref: par. .A18)

   iii. significant transactions occurring or recognized in the interim period, particularly those in the last several days of the interim period.

   iv. the status of uncorrected misstatements identified during the previous audit and interim review (that is, whether adjustments had been recorded subsequent to the periods covered by the prior audit or interim review and, if so, the amounts recorded and period in which such adjustments were recorded).

v. matters about which questions have arisen in the course of applying the review procedures.

vi. events subsequent to the date of the interim financial information that could have a material effect on the fair presentation of such information.

vii. its knowledge of any fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others when the fraud could have a material effect on the financial information.

viii. whether management is aware of allegations of fraud or suspected fraud affecting the entity communicated by employees, former employees, regulators, or others.

ix. significant journal entries and other adjustments.

x. communications from regulatory agencies.

xi. significant deficiencies and material weaknesses in the design or operation of internal control as it relates to the preparation and fair presentation of both annual and interim financial information.

xii. changes in related parties or significant new related party transactions.

d. Obtain evidence that the interim financial information agrees or reconciles with the accounting records. In addition, the auditor should inquire of management about the reliability of the records to which the interim financial information was compared or reconciled. (Ref: par. .A19)

e. Read the interim financial information to consider whether, based on the results of the review procedures performed and other information that has come to the auditor's attention, the information to be reported is in accordance with the applicable financial reporting framework.

f. Read other information in documents containing the interim financial information to consider whether such information or the manner of its presentation is materially inconsistent with the interim financial information. If the auditor concludes that a material inconsistency exists or becomes aware of information that the auditor believes is a material misstatement of fact, the auditor should take action based on the auditor's professional judgment. (Ref: par. .A22–.A23)

Inquiry Concerning Litigation, Claims, and Assessments

.15 If information comes to the auditor's attention regarding litigation, claims, or assessments that leads the auditor to question whether the interim financial information has been prepared, in all material respects, in accordance with the applicable financial reporting framework, and the auditor believes that the entity's internal or external legal counsel may have relevant information, the auditor should inquire of such legal counsel concerning litigation, claims, and assessments. (Ref: par. .A22)

Inquiry Concerning an Entity's Ability to Continue as a Going Concern

.16 If the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information, the auditor should perform interim review procedures related to (*a*) whether the going concern basis of accounting is appropriate; (*b*) management's evaluation of whether there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern; (*c*) if there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters; and (*d*) the adequacy of the related disclosures in the interim financial information. (Ref: par. .A23–.A24) [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.17 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information and (*a*) conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (*b*) in the course of performing review procedures on the current period interim financial information, the auditor becomes aware of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, the auditor should

a. inquire of management whether the going concern basis of accounting is appropriate,

b. inquire of management about its plans for dealing with the adverse effects of the conditions and events, and (Ref: par. .A25)

c. consider the adequacy of the disclosure about such matters in the interim financial information. (Ref: par. .A26)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

Consideration of Management's Responses and Extension of Interim Review Procedures

.18 The auditor should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the auditor's knowledge of the entity's business and its internal control. However, the auditor is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.19 When a matter comes to the auditor's attention that leads the auditor to question whether the interim financial information has been prepared in accordance with the applicable financial reporting framework in all material respects, the auditor should make additional inquiries of management or others or perform other procedures to provide a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information. (Ref: par. .A27) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Evaluating the Results of Interim Review Procedures

.20 The auditor should accumulate misstatements, including inadequate disclosure, identified by the auditor in performing the review procedures or brought to the auditor's attention during the performance of the review. (Ref: par. .A28) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.21 The auditor should evaluate, individually and in the aggregate, misstatements, including inadequate disclosure, accumulated in accordance with paragraph .20 to determine whether material modification should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework. (Ref: par. .A29–.A30) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Written Representations From Management

.22 For all interim financial information presented and for all periods covered by the review, the auditor should request management to provide written representations, as of the date of the auditor's review report (Ref: par. .A31–.A32)

a. that management has fulfilled its responsibility for the preparation and fair presentation of the interim financial information, in accordance with the applicable financial reporting framework, as set out in the terms of the engagement.

b. that management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of interim financial statements, including its responsibility to prevent and detect fraud.

c. that management has disclosed to the auditor all significant deficiencies and material weaknesses in the design or operation of internal control of which management is aware as it relates to the preparation and fair presentation of both annual and interim financial information.

d. that management has provided the auditor with all relevant information and access, as agreed upon in the terms of the engagement.

e. that all transactions have been recorded and are reflected in the interim financial information.

f. that management has disclosed to the auditor the results of its assessment of the risk that the interim financial information may be materially misstated as a result of fraud.

g. that management has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving

    i. management,

   ii. employees who have significant roles in internal control, or
   iii. others when the fraud could have a material effect on the interim financial information.

h. that management has disclosed to the auditor its knowledge of any allegations of fraud or suspected fraud affecting the entity's interim financial information communicated by employees, former employees, regulators, or others.

i. that management has disclosed to the auditor all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing interim financial information.

j. about whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the interim financial information as a whole. A summary of such items should be included in, or attached to, the written representation. (Ref: par. .A33)

k. that management has disclosed to the auditor all known actual or possible litigation and claims whose effects should be considered when preparing the interim financial information, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.

l. about whether management believes that significant assumptions used by it in making accounting estimates are reasonable.

m. that management has disclosed to the auditor the identity of all the entity's related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.

n. that all events occurring subsequent to the date of the interim financial information and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135.]

.23 If the auditor has concerns about the reliability of the representations or if management does not provide the requested written representations, the auditor should take appropriate action. When management does not provide the written representations described in paragraph .22*a*–*e*, the auditor should withdraw from the engagement to review the interim financial information. (Ref: par. .A34) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Communications With Management and Those Charged With Governance

Matters Affecting the Completion of the Review

.24 If the auditor cannot complete the review, the auditor should communicate to the appropriate level of management and those charged with governance

a. the reason why the review cannot be completed;

b. that an incomplete review does not provide a basis for reporting and, accordingly, that the auditor is precluded from issuing a review report; and

c. any material modifications of which the auditor has become aware that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework, in accordance with paragraphs .25–.27. (Ref: par. .A35)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.25 The auditor should communicate to the appropriate level of management, as soon as practicable, matters that come to the auditor's attention during the conduct of the review that cause the auditor to believe that

a. material modification should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework, or

b. the entity issued the interim financial information before the completion of the review.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.26 If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform those charged with governance of the matters as soon as practicable. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.27 If, in the auditor's judgment, those charged with governance do not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should consider whether to withdraw (*a*) from the engagement to review the interim financial information and (*b*) if applicable, from serving as the entity's auditor. (Ref: par. .A36) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Other Matters

.28 If the auditor becomes aware that fraud may have occurred, the auditor should communicate the matter as soon as practicable to the appropriate level of management. If the fraud involves senior management or results in a material misstatement of the interim financial information, the auditor should communicate the matter directly to those charged with governance. If the auditor becomes aware of matters involving identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing interim financial information, the auditor should communicate the matters to those charged with governance, other than when the matters are clearly inconsequential. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.29 The auditor should communicate relevant matters of governance interest arising from the review of interim financial information to those charged with governance, including the following:

a. Significant deficiencies or material weaknesses in internal control as it relates to the preparation and fair presentation of annual and interim financial information (Ref: par. .A37)

b. Any of the matters described in section 260, *The Auditor's Communication With Those Charged With Governance*, that have been identified, as they relate to the interim financial information (Ref: par. .A38–.A40)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

The Auditor's Report on a Review of Interim Financial Information

Form of the Auditor's Review Report

.30 The auditor's review report should be in writing. (Ref: par. .A41–.A42) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.31 The written review report should include the following: (Ref: par. .A43–.A44)

a. A title that clearly indicates that it is the report of an independent auditor.

b. An addressee as appropriate based on the circumstances of the engagement. `(Ref: par. .A45)

c. The first section of the auditor's report on a review of interim financial information should include the auditor's conclusion and the heading, "Results of Review of Interim Financial Information," and the following elements:

   i. The name of the entity whose interim financial information has been reviewed

   ii. A statement that the interim financial information identified in the report was reviewed

   iii. The title of each statement that interim financial information comprises (Ref: par. .A46–.A47)

   iv. A reference to the notes

   v. The dates of or periods covered by each financial statement that the interim financial information comprises

   vi. A statement about whether the auditor is aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable (Ref: par. .A48–.A51)

d. A section, directly following the "Results of Interim Financial Information" section, that includes the heading, "Basis for Review Results," and does the following: (Ref: par. . A52)

   i. States that the review was conducted in accordance with generally accepted auditing standards applicable to reviews of interim financial information and identifies the United States of America as the country of origin of those standards (Ref: par. .A53)

   ii. Includes a statement that a review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters

   iii. Includes a statement that a review of interim financial information is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, the auditor does not express such an opinion

   iv. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the review (Ref: par. .A54–.A55)

   v. States whether the auditor believes that the results of the review procedures provide a reasonable basis for the auditor's conclusion

e. A section that includes the heading "Responsibilities of Management for the Interim Financial Information" and includes a statement that management is responsible for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

f. The manual or printed signature of the auditor's firm. (Ref: par. .A56–.A58)

g. The city and state where the auditor's report is issued. (Ref: par. .A59)

h. The date of the review report, which should be dated no earlier than the date on which the auditor completed procedures sufficient to obtain a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information in order for it to be in accordance with the applicable financial reporting framework, including evidence of the following:(Ref: par. .A60)

i. All the statements and disclosures that the interim financial information comprises have been prepared.

ii. Management has asserted that it has taken responsibility for the interim financial information.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.32 The auditor should determine that management has clearly marked as unaudited each page of the interim financial information accompanying the review report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Comparative Interim Financial Information That Has Not Been Reviewed Presented With Reviewed Interim Financial Information

.33 If an auditor is engaged to perform a review of the most recent interim period in accordance with this section, and such financial information will be presented in comparative form with interim financial information of a prior period that has not been reviewed, such interim financial information should be accompanied by an indication in the auditor's review report that the auditor has not reviewed the prior period interim financial information and that the auditor assumes no responsibility for it. (Ref: par. .A61) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Interim Financial Information Presented With Condensed Balance Sheet Information for the Most Recent Year End

.34 When a condensed balance sheet derived from audited financial statements is presented on a comparative basis with the interim financial information, the auditor should report on the condensed balance sheet only when the auditor audited the financial statements from which the condensed balance sheet was derived. The auditor should compare the condensed balance sheet with the related information in the audited financial statements to determine whether the condensed balance sheet agrees with, or can be recalculated from, the related information in the audited financial statements. The auditor's report on the interim financial information should include a paragraph addressing the condensed balance sheet that

a. identifies the condensed balance sheet on which the auditor is reporting.

b. identifies the audited financial statements from which the condensed balance sheet was derived and indicates that such financial statements are not separately presented.

c. refers to the auditor's report on the audited financial statements, the date of that report, and the type of opinion expressed and, if the opinion is modified, the basis for the modification.

d. describes the nature of any emphasis-of-matter paragraph or other-matter paragraph included in the auditor's report.

e. includes an opinion about whether the condensed balance sheet is consistent, in all material respects, in relation to the audited financial statements from which it has been derived. (Ref: par. .A62)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Modification of the Auditor's Review Report

.35 When the interim financial information has not been prepared in accordance with the applicable financial reporting framework in all material respects, the auditor should consider whether modification of the auditor's review report on the interim financial information is sufficient to address the departure from the applicable financial reporting framework. (Ref: par. .A63–.A66) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.36 If the auditor concludes that modification of the standard review report is sufficient to address the departure, the auditor should modify the review report. The modification should describe the nature of the departure and, if practicable, should state the effects on the interim financial information. If the departure is due to inadequate disclosure, the auditor should, if practicable, include the information in the report that the auditor believes is necessary for adequate disclosure in accordance with the applicable financial reporting framework. (Ref: par. .A67) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.37 If the auditor believes that modification of the review report is not sufficient to address the deficiencies in the interim financial information, the auditor should withdraw from the review engagement and provide no further services with respect to such interim financial information. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Separate Section in the Auditor's Review Report Regarding Going Concern

.38 The auditor should include a separate section in the auditor's review report with the heading "Substantial Doubt About an Entity's Ability to Continue as a Going Concern" in any of the following circumstances, regardless of whether the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists: (Ref : par. .A68–.A70)

a. Such a section was included in the prior year's auditor's report and

    1. the conditions or events that caused the auditor to conclude that substantial doubt about the entity's ability to continue as a going concern continue to exist and

    2. those conditions or events continue to raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and management's plans do not alleviate them.

b. Such a section was not included in the prior year's auditor's report and

   i. management is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists and

   ii. management has included such statement in the notes to the interim financial information.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.39 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Subsequent Discovery of Facts Existing at the Date of the Auditor's Review Report

.40 If, subsequent to the date of the auditor's review report, the auditor becomes aware that facts existed at the date of the review report that might have affected the auditor's review report had the auditor then been aware of those matters, the auditor should apply the requirements and guidance, adapted as necessary, in section 560, *Subsequent Events and Subsequently Discovered Facts*. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Other Considerations

.41 If management does not include the auditor's review report in a report, document, or written communication containing the reviewed interim financial information that indicates that such information has been reviewed by the entity's auditor, despite having agreed in the terms of the engagement to do so, the auditor should perform the following procedures:

- Request that management amend the report, document, or written communication to include the auditor's review report and reissue the report, document, or written communication
- If management does not comply with the request to amend and reissue the report, document, or written communication, request that the auditor's name not be associated with the interim financial information or referred to in the report, document, or written communication because the auditor will not permit either the

use of the auditor's name or reference to the auditor unless the auditor's review report is included with the reviewed interim financial information in these circumstances

- Communicate management's noncompliance with the requests to those charged with governance
- When appropriate, recommend that the entity consult with its legal counsel about the application of relevant laws and regulations to the circumstances
- Consider what other actions might be appropriate (Ref: par. .A71)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.42 If the auditor has issued a modified review report due to a departure from the applicable financial reporting framework, and management issues the interim financial information without including the review report in the document containing the interim financial information, the auditor should determine the appropriate course of action in the circumstances, including whether to withdraw from the engagement to audit the annual financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Accompanying Audited Financial Statements

.43 The auditor should include an other-matter paragraph in the auditor's report on the audited financial statements when all the following conditions exist:

a. The interim financial information that has been reviewed in accordance with this section is included in a document containing audited financial statements.
b. The interim financial information accompanying audited financial statements does not appear to be presented in accordance with the applicable financial reporting framework.
c. The auditor's separate review report, which refers to the departure from the applicable financial reporting framework, is not presented with the interim financial information.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.44 The auditor is required by section 700, *Forming an Opinion and Reporting on Financial Statements*, to address in the auditor's report on the audited financial statements information that is not required by the applicable financial reporting framework but is nevertheless presented as part of the basic financial statements if it cannot be clearly differentiated.[3] When the interim financial information included in a note to the financial statements, including information that has been reviewed in accordance with this section,

[3]Paragraph .59 of section 700, *Forming an Opinion and Reporting on Financial Statements.* [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131.]

is not appropriately marked as unaudited, the auditor should, in the auditor's report on the audited financial statements, disclaim an opinion on the interim financial information. (Ref: par. .A72–.A73) [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Documentation

.45 The auditor should prepare documentation in connection with a review of interim financial information that will enable an experienced auditor, having no previous connection to the review, to understand

a. the nature, timing, and extent of the review procedures performed;

b. the results of the review procedures performed and the evidence obtained; and

c. significant findings or issues arising during the review, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.46 The documentation should include the communications required by this section, whether written or oral. (Ref: par. .A74–.A75) [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 The ability to apply this section even when the auditor does not expect to be engaged to audit the current year financial statements provides for appropriate transitions between the predecessor auditor and the auditor of the current year financial statements.

.A2 Appropriate financial reporting frameworks for condensed interim financial information may include, for example, Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 270, *Interim Reporting*, and Article 10 of Securities and Exchange Commission (SEC) Regulation S-X, with respect to accounting principles generally accepted in the United States of America, or International Accounting Standard 34, *Interim Financial Reporting*, with respect to International Financial Reporting Standards issued by the International Accounting Standards Board. FASB ASC 270 outlines the application of U.S. generally accepted accounting principles (GAAP) to the determination of income when interim financial information is presented, provides for the use of estimated effective income tax rates, and specifies certain disclosure requirements for condensed interim financial information issued by public companies and may be adapted by nonissuers as a fair presentation framework for condensed interim financial information. In addition to FASB ASC 270, other FASB ASC topics also include disclosure requirements for interim financial information.

The Meaning of Readily Available (Ref: par. .02d(iii))

.A3 Audited financial statements are deemed to be readily available if a third-party user can obtain the financial statements without any further action by the entity (for example, financial statements on an entity's website may be considered readily available, but being available upon request is not considered readily available).

Objective (Ref: par. .05)

.A4 The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with auditing standards generally accepted in the United States of America. A review of interim financial information does not provide a basis for expressing an opinion about whether the interim financial information is presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.A5 A review, in contrast to an audit, is not designed to provide the auditor with a basis for obtaining reasonable assurance that the interim financial information is free from material misstatement. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters and does not contemplate (*a*) tests of accounting records through inspection, observation, or confirmation; (*b*) tests of controls to evaluate their effectiveness; (*c*) the obtainment of corroborating evidence in response to inquiries; or (*d*) the performance of certain other procedures ordinarily performed in an audit. A review may bring to the auditor's attention significant findings or issues affecting the interim financial information, but it does not provide assurance that the auditor will become aware of all significant findings or issues that would be identified in an audit.

Acceptance

Agreement on Engagement Terms (Ref: par. .10)

.A6 The engagement letter or other suitable form of written agreement documenting the agreed-upon terms of the engagement with the entity regarding a review of interim financial information may use the following wording to include the information necessary to meet the requirements of paragraph .10:

Objectives and scope of the engagement

- The objective of a review of interim financial information is to provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.
- A review includes obtaining sufficient knowledge of the entity's business and internal control, as it relates to the preparation and fair presentation of both annual and interim financial information, to enable the auditor to

— identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.

— select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to conform with the applicable financial reporting framework.

Management's responsibilities

- Management is responsible for the following:

  — Preparing and presenting the interim financial information in accordance with the applicable financial reporting framework.

  — Designing, implementing, and maintaining internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework.

  — Providing the auditor with (*a*) access to all information of which management is aware that is relevant to the preparation and fair presentation of the interim financial information, such as records, documentation, and other matters; (*b*) additional information that the auditor may request from management for the purpose of the review; and (*c*) unrestricted access to persons within the entity of whom the auditor determines it necessary to make inquiries.

  — Including the auditor's review report in any document containing interim financial information that indicates that such information has been reviewed by the entity's auditor.

  — Identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

  — Providing the auditor, at the conclusion of the engagement, with a letter confirming certain representations made during the review.

  — Adjusting the interim financial information to correct material misstatements. Although a review of interim financial information is not designed to provide the auditor with reasonable assurance that the interim financial information is free from material misstatement, management nonetheless is responsible for affirming in its representation letter to the auditor that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the current year period(s) under review are immaterial, both individually and in the aggregate, to the interim financial information as a whole.

The auditor's responsibilities

- The auditor is responsible for conducting the review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information as a whole. Accordingly, the auditor will not express an opinion on the interim financial information.

Limitations of the engagement

- A review does not provide a basis for expressing an opinion about whether the interim financial information is presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- A review does not provide the auditor with a basis for obtaining reasonable assurance that the auditor will become aware of all significant findings or issues that would be identified in an audit.
- A review is not designed to provide the auditor with a basis for obtaining reasonable assurance on internal control or to identify significant deficiencies or material weaknesses in internal control; however, the auditor is responsible for communicating to management and those charged with governance any significant deficiencies or material weaknesses in internal control that the auditor identifies during the performance of review procedures.

Procedures for a Review of Interim Financial Information

Understanding the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: par. .11–.12)

.A7 As required by SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the auditor who has audited the entity's financial statements for one or more annual periods would have obtained an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control as it relates to the preparation and fair presentation of annual financial information, that was sufficient to conduct the audit. Internal control over the preparation and fair presentation of interim financial information may differ from internal control over the preparation and fair presentation of annual financial statements because certain accounting principles and practices used for interim financial information may differ from those used for the preparation of annual financial statements (for example, the use of estimated effective income tax rates for the preparation of interim financial information). [As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2023, by SAS No. 145.]

.A8 The auditor is unable to complete the review if the entity's internal control appears to contain deficiencies so significant that it would be impracticable for the auditor to effectively perform review procedures that would achieve the objective stated in paragraph

.05. Paragraph .24 addresses the auditor's responsibilities when the review cannot be completed.

.A9 In an initial review of interim financial information, when performing the procedures for a new client required by paragraph .07, the auditor also may consider requesting access to review the predecessor auditor's documentation related to reviews of an interim period or interim periods in the prior year. However, the inquiries made and analytical procedures performed, or other procedures performed in the initial review, and the conclusions reached are solely the responsibility of the auditor. Therefore, the auditor is not permitted to make reference to the report or work of the predecessor auditor as the basis, in part, for the auditor's own report.

.A10 If the predecessor auditor does not respond to the auditor's inquiries or does not allow the auditor to review the predecessor auditor's documentation, the auditor may inquire why and use alternative procedures to obtain the understanding required by paragraph .11.

Analytical Procedures, Inquiries, and Other Review Procedures

Analytical Procedures (Ref: par. .13)

.A11 Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, the results of the risk assessments relating to the preceding audit, and the auditor's consideration of materiality as it relates to the interim financial information, influences the nature and extent of the inquiries made and analytical procedures performed. For example, if the auditor becomes aware of a significant change in the entity's control activities at a particular location, the auditor may consider the following procedures:

- Making additional inquiries, such as whether management monitored the changes and considered whether they were operating as intended
- Employing analytical procedures with a more precise expectation

[As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2023, by SAS No. 145.]

.A12 Examples of analytical procedures that an auditor may consider performing when conducting a review of interim financial information are contained in appendix A, "Analytical Procedures the Auditor May Consider Performing When Conducting a Review of Interim Financial Information." The auditor also may find the guidance in section 520, *Analytical Procedures*, useful in conducting a review of interim financial information.

.A13 Expectations developed by the auditor in performing analytical procedures in connection with a review of interim financial information ordinarily are less precise than those developed in an audit. Also, in a review, the auditor is not required to corroborate management's responses with other evidence.

.A14 In considering plausible relationships, the auditor may consider information developed and used by the entity (for example, analyses prepared for management or those charged with governance).

.A15 To compare disaggregated revenue data, the auditor may compare, for example, revenue reported by month and product line or operating segment during the current interim period with that of comparable prior periods.

Inquiries and Other Review Procedures (Ref: par. .14)

.A16 Many of the inquiries and review procedures can be performed before, or simultaneously with, the entity's preparation of the interim financial information. For example, the auditor may update the understanding of the entity's internal control and begin reading applicable minutes before the end of an interim period. Performing some of the review procedures earlier in the interim period also permits early identification and consideration of significant findings and issues affecting the interim financial information. In addition, when the auditor performing the review of interim financial information is also engaged to perform an audit of the annual financial statements of the entity, certain auditing procedures associated with the annual audit of the financial statements may be performed concurrently with the review of interim financial information. For example, information gained from reading the minutes of meetings of the board of directors in connection with the review also may be relevant to the annual audit. Also, there may be significant or unusual transactions occurring during an interim period (for example, business combinations, restructurings, or significant revenue transactions) for which the procedures that would need to be performed for purposes of the audit of the annual financial statements could be performed, to the extent practicable, at the time of the review of the interim period in which the transactions are first recorded.

.A17 The auditor may find the guidance in section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, useful in conducting a review of interim financial information for an entity that prepares group financial statements.

.A18 Examples of unusual or complex situations about which the auditor may inquire of management are contained in appendix B, "Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information."

.A19 To obtain evidence that the interim financial information agrees or reconciles with the accounting records, the auditor may compare the interim financial information to (*a*) the accounting records, such as the general ledger; (*b*) a consolidating schedule derived from the accounting records; or (*c*) other supporting data in the entity's records.

[.A20] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

[.A21] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

Inquiry Concerning Litigation, Claims, and Assessments (Ref: par. .15)

.A22 A review of interim financial information does not contemplate obtaining corroborating evidence for responses to inquiries, such as those concerning litigation, claims, and assessments. Consequently, the auditor is not required to send an inquiry letter to an entity's legal counsel concerning litigation, claims, and assessments.

Inquiry Concerning an Entity's Ability to Continue as a Going Concern (Ref: par. .16–.17)

.A23 The nature and extent of the auditor's interim review procedures are matters of the auditor's professional judgment. For example, when a history of profitable operations and ready access to financing exists, inquiry alone might be sufficient to review the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A24 Certain financial reporting frameworks require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information.[4] For example, FASB ASC requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern.[5] Under FASB ASC, the evaluation period is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).[6] [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A25 A review of interim financial information is not designed to identify conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. However, conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time may have existed at the date of the prior period financial statements or may be identified as a result of inquiries of management or in the course of performing other review procedures. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A26 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, may provide useful guidance to the auditor when considering whether there is adequate and appropriate disclosure in the interim financial information about the entity's ability to continue as a going concern for a reasonable period of time[7] when

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[4]See paragraph .11 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, for the definition of *reasonable period of time*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

[5]"Pending Content" in FASB *Accounting Standards Codification* (ASC) 205-40-50-1. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

[6]See footnote 5. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

[7]Paragraphs .22–.23 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

a. conditions or events have been identified as of the interim reporting date covered by the review and substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time exists, or

b. the auditor's report for the prior year end contained an emphasis-of-matter paragraph indicating the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, and the conditions that raised such doubt continued to exist as of the interim reporting date covered by the review.

If the auditor determines that the disclosure related to substantial doubt about the entity's ability to continue as a going concern is inadequate, resulting in a departure from the applicable financial reporting framework, the auditor is required by paragraph .35 to modify the report. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

Consideration of Management's Responses and Extension of Interim Review Procedures (Ref: par. .19)

.A27 The auditor's interim review procedures may lead the auditor to make additional inquiries, such as questioning whether, for example, a significant sales transaction is recorded in accordance with the applicable financial reporting framework. Additional procedures that the auditor may perform to resolve such questions include discussing the terms of the transaction with senior sales and accounting personnel, reading the sales contract, or both. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Evaluating the Results of Interim Review Procedures (Ref: par. .20–.21)

.A28 The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts would not have a material effect on the interim financial information.[8] [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A29 As noted in paragraph .A2, appropriate financial reporting frameworks for interim financial information may include, for example, FASB ASC 270 and Article 10 of SEC Regulation S-X. FASB ASC 270 describes the applicability of GAAP to interim financial information and indicates the types of disclosures necessary to report on a meaningful basis for a period of less than one full year. FASB ASC 270-10-45-16 provides guidance on assessing materiality in interim periods. For example, it states that in determining materiality for the purpose of reporting the correction of an error, amounts shall be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings. Further, Rule 10-01(a)(5) of SEC Regulation S-X states the following:

> The interim financial information shall include disclosures either on the face of the financial statements or in accompanying footnotes sufficient so as to

[8]Paragraph .A2 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 132, February 2017.]

> make the interim information presented not misleading. Registrants may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, and detailed disclosures prescribed by Rule 4-08 of this Regulation, may be omitted. However, disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant. Disclosures should encompass for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices; estimates inherent in the preparation of the financial statements; status of long-term contracts; capitalization including significant new borrowings or modification of existing financing arrangements; and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A30 Considerations that may affect the evaluation of whether uncorrected misstatements, individually or in the aggregate, are material include the following:

- The nature, cause (if known), and amount of the misstatements
- Whether the misstatements originated in the preceding year or interim periods of the current year
- Materiality judgments made in conjunction with the current or prior year's annual audit
- The potential effect of the misstatements on future interim or annual periods
- The appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement
- Recognition that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods

Section 450, *Evaluation of Misstatements Identified During the Audit*, provides guidance regarding qualitative considerations in evaluating whether misstatements are material. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Written Representations From Management (Ref: par. .22–.23)

.A31 Exhibit A, "Illustrative Management Representation Letters for a Review of Interim Financial Information," contains illustrative representation letters for engagements to review interim financial information. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A32 The auditor may request additional representations, including representations regarding the following:

- Matters specific to the entity's business or industry
- Support for any assertion that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction
- Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135.]

.A33 If no uncorrected misstatements were identified, the representation regarding uncorrected misstatements is not relevant and, accordingly, is not required. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A34 Appropriate action when management does not provide one or more requested written representations or when the auditor has concerns about the reliability of the representations may include

- discussing the matter with management and, when relevant, those charged with governance;
- reevaluating the integrity of management and evaluating the effect that this may have on the reliability of representations (oral or written) and evidence in general; and
- considering whether to withdraw from the engagement to review the interim financial information and, if applicable, as the entity's auditor.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Communications With Management and Those Charged With Governance

Matters Affecting the Completion of the Review (Ref: par. .24 and .27)

.A35 When an auditor is unable to perform the procedures that the auditor considers necessary to achieve the objective of a review of interim financial information, or management does not provide the auditor with the written representations that the auditor believes are necessary, the review will be incomplete. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A36 The auditor may seek legal advice when considering whether to withdraw from the engagement to review the interim financial information and as the entity's auditor. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Other Matters (Ref: par. .29)

.A37 Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, provides guidance on identifying and communicating deficiencies in internal control. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A38 As a result of performing the review of the interim financial information, the auditor may become aware of matters that, in the opinion of the auditor, are both significant and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Examples of such matters include the following:

- A change in a significant accounting policy affecting the interim financial information
- Adjustments that either individually or in the aggregate could have a significant effect on the entity's financial reporting process
- Uncorrected misstatements aggregated by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial information as a whole

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A39 The objective of a review of interim financial information differs significantly from that of an audit. Therefore, any communication that the auditor may make about the quality, not just the acceptability, of the entity's accounting principles as applied to its interim financial reporting generally is limited to the effect of significant events, transactions, and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the auditor will become aware of all matters that might affect the auditor's judgments about the quality of the entity's accounting principles that would be identified as a result of an audit. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A40 The communications required by paragraphs .24–.29 may be oral or written. The communications are most helpful when made on a sufficiently timely basis to enable management or those charged with governance to take appropriate action. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

The Auditor's Report on a Review of Interim Financial Information

Form of the Auditor's Review Report (Ref: par. .30–.31)

.A41 A written report encompasses reports issued in hard copy format and those using an electronic medium. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A42 Entities may be required by third parties to engage auditors to perform a review of interim financial information, but such third parties may choose to not require that a written auditor's review report on such information be provided to users of the entity's interim financial information. For example, entities that trade unregistered private equity securities on electronic trading platforms, often referred to as private equity exchanges, may be required to provide financial and other information to the qualified investors on the exchange's website. The ongoing reporting requirements of these exchanges are substantially similar to the reporting required of issuers, wherein entities trading securities on such exchanges are required to engage auditors to review their interim financial information but are not required to include written review reports with interim financial information provided to qualified investors. Nonetheless, in accordance with paragraph .30, the auditor's report on the review of the interim financial information is required to be in writing. [Paragraph subsequently renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A43 Reporting considerations related to the dating of reports or subsequent events encountered during a review are similar to those encountered in an audit of financial statements. Sections 560 and 700 provide guidance on these issues. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A44 Exhibit B, "Illustrations of Auditor's Review Reports on Interim Financial Information," contains illustrations of review reports. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Addressee (Ref: par. .31b)

.A45 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose interim financial information is being reviewed or to those charged with governance. A report on the interim financial information of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Results of Review of Interim Financial Information (Ref: par. .31c)

.A46 The identification of the title and the dates of, or periods covered by, each statement that the interim financial information comprises may also be achieved by referencing the table of contents in a document bound with or accompanying the interim financial information and auditor's report thereon. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A47 When the auditor is aware that the reviewed interim financial information will be included in a document that contains information in addition to the interim financial information and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the reviewed interim financial information is presented. This helps users identify the interim financial information to which the auditor's report relates. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A48 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance, requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.[9] That description is important because it advises users of the financial statements of the framework on which the financial statements are based. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A49 The title of the financial statements identified in the "Results of Review of Interim Financial Information" section describes the information that is the subject of the auditor's conclusion. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A50 The auditor's conclusion covers the *interim financial information*, as defined by the applicable financial reporting framework. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A51 The identification of the applicable financial reporting framework in the auditor's conclusion is intended to advise users of the auditor's report of the context in which the auditor's conclusion is expressed. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB) or *International Financial Reporting Standard for Small- and Medium-Sized Entities promulgated by the IASB.* [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Basis for Review Results (Ref: par. .31d)

.A52 The "Basis for Review Results" section provides important context about the auditor's conclusion. Accordingly, this section requires the "Basis for Review Results" section to directly follow the "Results of Review of Interim Financial Information" section in the auditor's report. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

[9] Paragraphs .A2–.A3 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards.* [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A53 The reference to the standards used conveys to the users of the auditor's report that the review has been conducted in accordance with established standards. For example, the auditor's report may refer to *auditing standards generally accepted in the United States of America* or *U.S. generally accepted auditing standards applicable to reviews of interim financial information.* [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Relevant Ethical Requirements (Ref: par. .31d(v))

.A54 Section 200 explains that *ethical requirements* consist of the AICPA Code of Professional Conduct (AICPA code) together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.[10] When the AICPA code applies, the auditor's other ethical responsibilities relate to the principles of professional conduct "Principles of Professional Conduct" (ET sec. 0.300). [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A55 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA code, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. Section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,[11] provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Signature of the Auditor (Ref: par. .31g)

.A56 In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A57 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

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[10] Paragraph .A15 of section 200. [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

[11] Paragraphs .22–.23 of section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors).* [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A58 This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor's report when, in certain situations, the governmental auditor is required by law or regulation or chooses to do so. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Auditor's Address (Ref: par. .31h)

.A59 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Date of the Auditor's Report (Ref: par. .31i)

.A60 When an engagement quality control review is performed, section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that the auditor's report not be released prior to the completion of the engagement quality control review.[12] [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Comparative Interim Financial Information That Has Not Been Reviewed Presented With Reviewed Interim Financial Information (Ref: par. .33)

.A61 The indication that the auditor has not reviewed the prior period interim financial information and that the auditor assumes no responsibility for it may be worded, for example, as follows:

> The accompanying [*describe the interim financial information or statements*] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month period then ended were not reviewed by us, and accordingly, we do not express any form of assurance on it.

[Paragraph subsequently renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Presented With Condensed Balance Sheet Information for the Most Recent Year End (Ref: par. .34)

.A62 Because interim financial reporting is intended to be an update to year-end reporting, condensed balance sheet information as of the most recent year end often is presented for comparative purposes with the corresponding information as of the latest interim

[12]Paragraph .21 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.* [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

period. Appendix B includes an illustration of a review report on comparative interim financial information that includes a condensed balance sheet derived from audited financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Modification of the Auditor's Review Report (Ref: par. .35–.36)

.A63 Departures from the applicable financial reporting framework include inadequate disclosure and changes in accounting policies that are not in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A64 Section 700 addresses the reporting requirements when the circumstances contemplated by the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct are present. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A65 If the interim financial information adequately discloses a lack of consistency in the application of accounting principles affecting the interim financial information, the auditor may, but is not required to, include an emphasis-of-matter paragraph in the auditor's review report. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A66 Exhibit C, "Illustrations of Example Modifications to the Auditor's Review Report Due to Departures From the Applicable Financial Reporting Framework," contains illustrative examples of paragraphs modifying the auditor's review report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A67 The information necessary for adequate disclosure is influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of FASB ASC 270-10-50-1, which is applicable to condensed financial statements of public companies, are considerably less extensive than those necessary for annual financial statements that present financial position, results of operations, and cash flows in accordance with the applicable financial reporting framework. FASB ASC 270-10-50-3 states that a presumption exists that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by GAAP and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Separate Section in the Auditor's Review Report Regarding Going Concern (Ref: par. .38)

.A68 See exhibit D, "Illustrations of the Separate Section in the Auditor's Review Report Regarding Going Concern," for illustrative examples of such separate section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A69 If conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, but (*a*) no statement relating to substantial doubt is included in the notes to the interim financial information because management's plans have alleviated the substantial doubt or (*b*) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information, the auditor may include a separate section when management has disclosed the conditions or events in the notes to the financial statements but a statement related to substantial doubt is not required to be included by the applicable financial reporting framework. The following is an illustration of a separate section in the auditor's review report regarding going concern when no statement relating to substantial doubt is included in the notes to the interim financial information but conditions or events are disclosed:

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's plans in regards to these matters are also described in Note X.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A70 Paragraph .A47 of section 570 provides guidance when conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and (*a*) management's plans have not alleviated the substantial doubt, and (*b*) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Other Considerations (Ref: par. .41)

.A71 The auditor may seek legal advice in considering what actions, if any, may be appropriate in these circumstances. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Accompanying Audited Financial Statements (Ref: par. .44)

.A72 Interim financial information may accompany audited financial statements. If management chooses or is required to present interim financial information in a note to the audited financial statements, management is responsible for clearly marking the information as unaudited in the note. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A73 Because the interim financial information has not been audited and is not required for the audited financial statements to be fairly stated in accordance with the applicable financial reporting framework, the auditor ordinarily need not modify the auditor's report on the audited financial statements to refer to the interim financial information accompanying the audited financial statements, including when the auditor has performed a review in accordance with this section. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Documentation (Ref: par. .44–.46)

.A74 The auditor may find the guidance in section 230, *Audit Documentation*, useful in determining the form and content of the review documentation, including guidance on the timing of the final assembly of the engagement documentation. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A75 Examples of findings or issues that, in the auditor's judgment, are significant include the results of review procedures that indicate that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Appendix A — Analytical Procedures the Auditor May Consider Performing When Conducting a Review of Interim Financial Information (Ref: par. .A12)

.A76 Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the interim financial information. Examples of analytical procedures that an auditor may consider performing in a review of interim financial information include the following:

- Comparing current interim financial information with the interim financial information of the immediately preceding interim period, the interim financial information of the corresponding interim period of the preceding financial year, and the most recent audited annual financial statements.
- Comparing current interim financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current interim financial information with corresponding information in (*a*) budgets, using expected rates, and (*b*) financial information for prior periods). Caution is necessary when comparing and evaluating current interim financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired interim results.
- Comparing current interim financial information with relevant nonfinancial information.
- Comparing ratios and indicators for the current interim period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current interim financial information and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current interim period with those of entities in the same industry.
- Comparing relationships among elements in the current interim financial information with corresponding relationships in the interim financial information of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
    - — By period (for example, interim financial information items disaggregated into quarterly, monthly, or weekly amounts)

— By product line or operating segment

— By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Appendix B — Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information (Ref: par. .A18)

.A77 The following are examples of situations about which the auditor may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters
- Infrequent transactions
- Significant unusual transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Exhibit A — Illustrative Management Representation Letters for a Review of Interim Financial Information (Ref: par. .A31)

.A78

The following management representation letters, which relate to a review of interim financial information, are presented for illustrative purposes only.

> Illustration 1 — Short Form Representation Letter for a Review of Interim Financial Information
>
> Illustration 2 — Detailed Representation Letter for a Review of Interim Financial Information

It is assumed in these illustrations that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's possible inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

Illustration 1 — Short Form Representation Letter for a Review of Interim Financial Information

This representation letter is to be used in conjunction with the representation letter for the audit of the financial statements of the prior year. Management confirms the representations made in the representation letter for the audit of the financial statements of the prior year end, as they apply to the interim financial information, and makes additional representations that may be needed for the interim financial information.

[*Date*]

To [*Independent Auditor*]:

This representation letter is provided in connection with your review of the [*consolidated*] balance sheet as of June 30, 20X1 and the related [*consolidated*] statements of income, changes in equity, and cash flows for the six-month period then ended of ABC Company for the purpose of reporting whether any material modifications should be made to the [*consolidated*] interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) [*including, if appropriate, an indication as to the appropriate form and content of interim financial information (for example, Article 10 of SEC Regulation S-X)*].

We confirm that [*, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*] [*as of (date of auditor's review report),*]:

Interim Financial Information

1. We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated [*insert date*] for the preparation and fair presentation of interim financial information in accordance with U.S. GAAP; in particular the interim financial information is presented in accordance therewith.

2. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

3. The interim financial information has been adjusted or includes disclosures for all events subsequent to the date of the interim financial information for which U.S. GAAP requires adjustment or disclosure.

4. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the interim financial information as a whole. A list of the uncorrected misstatements is attached to the representation letter.

[*Any other matters that the auditor may consider appropriate*]

Information Provided

5. We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation and fair presentation of the interim financial information such as records, documentation, and other matters;
- Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared;
- Additional information that you have requested from us for the purpose of the review; and
- Unrestricted access to persons within the entity of whom you determined it necessary to make inquiries.

6. We have disclosed to you all significant deficiencies or material weaknesses in the design or operation of internal control of which we are aware, as it relates to the preparation and fair presentation of both annual and interim financial information.

7. We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as a result of fraud.

8. We have [*no knowledge of any*] [*disclosed to you all information of which we are aware in relation to*] fraud or suspected fraud that affects the entity and involves:

- Management;
- Employees who have significant roles in internal control; or
- Others when the fraud could have a material effect on the interim financial information.

9. We have [*no knowledge of any*] [*disclosed to you all information in relation to*] allegations of fraud, or suspected fraud, affecting the entity's interim financial information communicated by employees, former employees, analysts, regulators, or others.

10. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

[*Any other matters that the auditor may consider necessary*]

11. We have reviewed our representation letter to you dated [*date of representation letter relating to most recent audit*] with respect to the audited consolidated financial statements as of and for the year ended [*prior year-end date*]. We believe that representations [*references to applicable representations*] within that representation letter do not apply to the interim financial information referred to above. We now confirm those representations [*references to applicable representations*], as they apply to the interim financial information referred to above, and incorporate them herein, with the following changes:

[*Indicate any changes.*]

12. [*Add any representations related to new accounting or auditing standards that are being implemented for the first time*.]

[*Name of Chief Executive Officer and Title*]

[*Name of Chief Financial Officer and Title*]

[*Name of Chief Accounting Officer and Title*]

Illustration 2 — Detailed Representation Letter for a Review of Interim Financial Information

This representation letter is similar in detail to the management representation letter used for the audit of the financial statements of the prior year and, thus, need not refer to the written management representations received in the most recent audit.

[*Date*]

To [*Independent Auditor*]:

This representation letter is provided in connection with your review of the [*consolidated*] balance sheet as of June 30, 20X1 and the related [*consolidated*] statements of income, changes in equity, and cash flows for the six-month period then ended of ABC Company for the purpose of reporting whether any material modifications should be made to the [*consolidated*] interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) [*including, if appropriate, an indication as to the appropriate form and content of interim financial information (for example, Article 10 of SEC Regulation S-X)*].

We confirm that [*, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*] [*as of (date of auditor's review report),*]:

Interim Financial Information

1. We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated [*insert date*] for the preparation and fair presentation of the interim financial information in accordance with U.S. GAAP; in particular the interim financial information is presented in accordance therewith.

2. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

3. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

4. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.

5. The interim financial information has been adjusted or includes disclosures for all events subsequent to the date of the interim financial information for which U.S. GAAP requires adjustment or disclosure.

6. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the interim financial information as a whole. A list of the uncorrected misstatements is attached to the representation letter.

[*Any other matters that the auditor may consider appropriate*]

Information Provided

7. We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation and fair presentation of the interim financial information such as records, documentation, and other matters;
- Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared;
- Additional information that you have requested from us for the purpose of the review; and
- Unrestricted access to persons within the entity of whom you determined it necessary to make inquiries.

8. All transactions have been recorded in the accounting records and are reflected in the interim financial information.

9. We have disclosed to you all significant deficiencies or material weaknesses in the design or operation of internal control of which we are aware, as it relates to the preparation and fair presentation of both annual and interim financial information.

10. We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as a result of fraud.

11. We have [*no knowledge of any*][*disclosed to you all information of which we are aware in relation to*] fraud or suspected fraud that affects the entity and involves:

- Management;
- Employees who have significant roles in internal control; or
- Others when the fraud could have a material effect on the interim financial information.

12. We have [*no knowledge of any*][*disclosed to you all information in relation to*] allegations of fraud, or suspected fraud, affecting the entity's interim financial information communicated by employees, former employees, analysts, regulators, or others.

13. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing interim financial information.

14. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.

15. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

[*Any other matters that the auditor may consider necessary*]

[*Name of Chief Executive Officer and Title*]

[*Name of Chief Financial Officer and Title*]

[*Name of Chief Accounting Officer and Title*]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Exhibit B — Illustrations of Auditor's Review Reports on Interim Financial Information (Ref: par. .A44)

.A79

Illustration 1 — A Review Report on Interim Financial Information

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Illustration 1 — A Review Report on Interim Financial Information

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures

<u>Independent Auditor's Review Report</u>

[*Appropriate Addressee*]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*] and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

The following is an example of a review report on a condensed balance sheet as of March 31, 20X1; the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0; and a condensed balance sheet derived from audited financial statements as of December 31, 20X0. If the auditor's report on the preceding year-end financial statements was other than unmodified or included a separate section regarding going concern or an emphasis-of-matter paragraph because of an inconsistency in the application of accounting principles, the last paragraph of the illustrative report would be appropriately modified.

Independent Auditor's Review Report

[*Appropriate Addressee*]

Results of Review of Interim Financial Information

We have reviewed the condensed consolidated financial statements of ABC Company and subsidiaries, which comprise the balance sheet as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, and the related notes (collectively referred to as the *interim financial information*).

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.*]

Basis for Review Results

We conducted our reviews in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of condensed interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of condensed interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the condensed interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of*

America] and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

Report on Condensed Balance Sheet as of [* **Date**]***

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated February 15, 20X1. In our opinion, the accompanying condensed consolidated balance sheet of ABC Company and subsidiaries as of December 31, 20X0, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.
- The auditor is making reference to another auditor's review report on the interim financial information of a significant component of a reporting entity.

Independent Auditor's Review Report

[*Appropriate Addressee*]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, and the review report of other auditors, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.*]

We were furnished with the report of other auditors on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three-month and nine-month periods then ended, constituted 15%, 20%, and 22%, respectively, of the related consolidated totals.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*] and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures as of March 31, 20X1, and for the three-month period then ended.
- Comparative information is presented for the balance sheet as of December 31, 20X0, and for the statements of income and cash flows for the comparable interim period.
- The December 31, 20X0, financial statements were audited, and the March 31, 20X0, interim financial information was reviewed, by another auditor.

Independent Auditor's Review Report

[*Appropriate Addressee*]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and subsidiaries as of March 31, 20X1, and for the three-month period then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review we are not aware of any material modifications that should be made to the accompanying interim financial information as of and for the three months ended March 31, 20X1, for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].

The consolidated statements of income and cash flows of ABC Company and subsidiaries for the three-month period ended March 31, 20X0, were reviewed by other auditors whose report dated June 1, 20X0, stated that based on their review, they were not aware of any material modifications that should be made to those statements in order for them to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]. The consolidated balance sheet of the Company as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein), were audited by other auditors whose report dated March 15, 20X1, expressed an unmodified opinion on those statements.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*] and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Exhibit C — Illustrations of Example Modifications to the Auditor's Review Report Due to Departures From the Applicable Financial Reporting Framework (Ref: par. .A66)

.A80

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

Illustration 2 — Modification Due to Inadequate Disclosure

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

The following is an example of a modification of the auditor's review report due to a departure from the applicable financial reporting framework:

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and its subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, with the exception of the matters described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].

Based on information furnished to us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that we believe should be capitalized to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]. This information indicates that if these lease obligations were capitalized at September 30, 20X1, property would be increased by $______, long-term debt would be increased by $______, and net income would be increased (decreased) by $________ and $________, respectively, for the three-month and nine-month periods then ended.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*] and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — Modification Due to Inadequate Disclosure

The following is an example of the second and third paragraphs of the auditor's review report when such report is modified due to inadequate disclosure:

Based on our review, with the exception of the matters described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.*]

Management has informed us that the Company is presently defending a claim regarding [*describe the nature of the loss contingency*] and that the extent of the Company's liability, if any, and the effect on the accompanying interim financial information is not determinable at this time. The interim financial information fails to disclose these matters, which we believe are required to be disclosed in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, SAS No. 140.]

Exhibit D — Illustrations of Separate Sections Regarding Going Concern in the Auditor's Review Report (Ref: par. .A68)

.A81

Illustration 1 — Separate Section When Substantial Doubt Is Disclosed in the Notes to the Latest Annual Audited Financial Statements and the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

Illustration 2 — Separate Section When Substantial Doubt Is Not Disclosed in the Notes to the Latest Annual Audited Financial Statements or the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

Illustration 3 — Separate Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information That Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement Is Included in the Notes to the Interim Financial Information, and a Separate Section Regarding Going Concern Was Not Included in the Prior Year's Audit Report

Illustration 1 — Separate Section When Substantial Doubt Is Disclosed in the Notes to the Latest Annual Audited Financial Statements and the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

The following is an example of situations in which (*a*) a separate section regarding going concern was included in the prior year's auditor's report, (*b*) conditions or events have been identified and substantial doubt continues to exist, and (*c*) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended, includes a statement that substantial doubt exists about the Company's ability to continue as a going concern. Note 4 of the Company's audited financial statements also discloses the events and conditions, management's evaluation of the events and conditions, and management's plans regarding these matters, including the fact that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor's report on those financial statements includes a separate section referring to the matters in Note 4 of those financial statements. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 2 — Separate Section When Substantial Doubt Is Not Disclosed in the Notes to the Latest Annual Audited Financial Statements or the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

The following is an example of a situation in which (*a*) a separate section regarding going concern was included in the prior year's auditor's report, (*b*) conditions or events have been identified and substantial doubt continues to exist, and (*c*) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended, discloses that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor's report on those financial statements includes a separate section referring to the matters in Note 4 of those financial statements, indicating that these matters raised substantial doubt about the Company's ability to continue as a going concern. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2. Management's evaluation of the conditions and events and management's plans regarding these matters are also disclosed in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 3 — Separate Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information That Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement Is Included in the Notes to the Interim Financial Information, and a Separate Section Regarding Going Concern Was Not Included in the Prior Year's Audit Report

The following is an example of a separate section when (*a*) a separate section regarding going concern was not included in the prior year's auditor's report, (*b*) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that conditions or events have been identified and substantial doubt exists, and (*c*) such statement is included in the notes to the interim financial information.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the interim financial information, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the conditions and events and management's plans regarding these matters are also described in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

AU-C Section 935

Compliance Audits

(Supersedes SAS No. 74.)

Source: SAS No. 117; SAS No. 122; SAS No. 123; SAS No. 125; SAS No. 130; SAS No. 140; SAS No. 148.

Effective for compliance audits for fiscal periods ending on or after June 15, 2010, unless otherwise indicated. Earlier application is permitted.

Note

In June 2022, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for compliance audits for fiscal periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction and Applicability

.01 Governments frequently establish governmental audit requirements for entities to undergo an audit of their compliance with applicable compliance requirements. This section is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of the following:

- Generally accepted auditing standards (GAAS)
- The standards for financial audits under *Government Auditing Standards*

- A governmental audit requirement that requires an auditor to express an opinion on compliance (Ref: par. .A1–.A2)

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits may be performed in conjunction with an audit of a complete set of financial statements, an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement. This section does not apply to an audit of a complete set of financial statements, an audit of a single financial statement, or an audit of a specific element, account, or item of a financial statement, even when such audit is performed in conjunction with a compliance audit. Certain AU-C sections are not applicable to a compliance audit, as identified in the appendix "AU-C Sections That Are Not Applicable to Compliance Audits." [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.03 This section is not applicable when the governmental audit requirement calls for an examination, in accordance with Statements on Standards for Attestation Engagements, of an entity's compliance with specified requirements or an examination of an entity's internal control over compliance. AT-C section 315, *Compliance Attestation*, is applicable to an examination of an entity's compliance with specified requirements and AT-C section 205, *Examination Engagements*, is applicable to an examination of an entity's internal control over compliance. If the entity is required to undergo a compliance audit and an examination of internal control over compliance, this section is applicable to performing and reporting on the compliance audit, and AT-C section 205 is applicable to performing and reporting on the examination of internal control over compliance. (Ref: par. .A2) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.04 Sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, those AU-C sections, or portions thereof, identified in the appendix cannot be adapted to a compliance audit because they address the matters that are not applicable to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.05 Except for the AU-C sections that are listed in the appendix as not applicable to a compliance audit, all of the other AU-C sections are applicable to a compliance audit. However, the auditor is not required, in planning and performing a compliance audit, to make a literal translation of each procedure that might be performed in a financial statement audit, but rather to obtain sufficient appropriate audit evidence to support the auditor's opinion on compliance. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.06 Some AU-C sections can be adapted and applied to a compliance audit with relative ease, for example, by simply replacing the word *misstatement* with the word *noncompliance*. Other AU-C sections are more difficult to adapt and apply and entail additional modification. For that reason, this section provides more specific guidance on how to adapt and apply certain AU-C sections to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.07 *Government Auditing Standards* and governmental audit requirements contain certain standards and requirements that are supplementary to those in GAAS, as well as guidance on how to apply those standards and requirements.

Management's Responsibilities

.08 A compliance audit is based on the premise that management is responsible for the entity's compliance with compliance requirements. Management's responsibility for the entity's compliance with compliance requirements includes the following:

a. Identifying the entity's government programs and understanding and complying with the compliance requirements

b. Designing, implementing, and maintaining effective controls that provide reasonable assurance that the entity administers government programs in compliance with the compliance requirements

c. Evaluating and monitoring the entity's compliance with the compliance requirements

d. Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Effective Date

.09 The provisions of this section are effective for compliance audits for fiscal periods ending on or after June 15, 2010. Earlier application is permitted.

Objectives (Ref: par. .A3)

.10 The auditor's objectives in a compliance audit are to

a. obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement about whether the entity complied in all material respects with the applicable compliance requirements; and

b. identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards*, if any, and perform procedures to address those requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Definitions

.11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

Applicable compliance requirements. Compliance requirements that are subject to the compliance audit.

Audit findings. The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

Audit risk of noncompliance. The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance.

Compliance audit. A program-specific audit or an organization-wide audit of an entity's compliance with applicable compliance requirements.

Compliance requirements. Laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to a government program with which the entity is required to comply.

Deficiency in internal control over compliance. A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance 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 properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively.

Detection risk of noncompliance. The risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material, either individually or when aggregated with other instances of noncompliance.

Government Auditing Standards. Standards and guidance issued by the Comptroller General of the United States, U.S. Government Accountability Office for financial audits, reviews of financial statements, attestation engagements, and performance audits. *Government Auditing Standards* also is known as generally accepted government auditing standards (GAGAS) or the Yellow Book.

Government program. The means by which governmental entities achieve their objectives. For example, one of the objectives of the U.S. Department of Agriculture is to provide nutrition to individuals in need. Examples of government programs designed to achieve that objective are the Supplemental Nutrition Assistance Program and the National

School Lunch Program. Government programs that are relevant to this section are those in which a grantor or pass-through entity provides an award to another entity, usually in the form of a grant, contract, or other agreement. Not all government programs provide cash assistance; sometimes noncash assistance is provided (for example, a loan guarantee, commodities, or property).

Governmental audit requirement. A government requirement established by law, statute, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. (Ref: par. .A4)

Grantor. A government agency from which funding for the government program originates.

Known questioned costs. Questioned costs specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs.

Likely questioned costs. The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

Material noncompliance. In the absence of a definition of material noncompliance in the governmental audit requirement, noncompliance with the applicable compliance requirements is considered quantitatively or qualitatively material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the government program as a whole.

Material weakness in internal control over compliance. A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.

Organization-wide audit. An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers.

Pass-through entity. An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

Program-specific audit. An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements.

Questioned costs. Costs that are questioned by the auditor because (1) of a violation or possible violation of the applicable compliance requirements, (2) the costs are not supported by adequate documentation, or (3) the incurred costs appear unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

Risk of material noncompliance. The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

Inherent risk of noncompliance. The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

Control risk of noncompliance. The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Requirements

Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: par. .A5 and .A42)

.12 When performing a compliance audit, the auditor, exercising professional judgment, should adapt and apply the AU-C sections to the objectives of a compliance audit, except for the AU-C sections listed in the appendix. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

Establishing Materiality Levels (Ref: par. .A6–.A8)

.13 The auditor should establish and apply materiality levels for the compliance audit based on the governmental audit requirement.

Identifying Government Programs and Applicable Compliance Requirements (Ref: par. .A9–.A11)

.14 As discussed in paragraph .08, a compliance audit is based on the premise that management is responsible for identifying the entity's government programs and understanding and complying with the compliance requirements. The auditor should determine which of those government programs and compliance requirements to test (that is, the applicable compliance requirements) in accordance with the governmental audit requirement.

Performing Risk Assessment Procedures (Ref: par. .A12–.A17)

.15 For each of the government programs and applicable compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the applicable compliance requirements and the entity's internal control over compliance with the applicable compliance requirements.[1]

.16 In adapting and applying the requirements of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, to identify controls that address risks of material noncompliance,[2] the auditor should perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material noncompliance are effectively designed and determine whether those controls have been implemented:

a. Controls over journal entries and other adjustments as required by section 240, *Consideration of Fraud in a Financial Statement Audit*

b. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include

   i. controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, and

   ii. controls that are required to be tested for operating effectiveness by the governmental audit requirement as required by paragraph .24 of this section

c. Other controls that, based on the auditor's professional judgment, the auditor considers appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures

[Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

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[1]Paragraphs .11–.19*a*, .19*c*, .21–.26, and .27*b*–.31 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[2]Paragraphs .27*b*–*d* and .30 of section 315. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.17 In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management's response to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements (for example, taking corrective action). The auditor should use this information to identify and assess risks of material noncompliance and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .A18–.A20)

.18 The auditor should identify the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity's compliance because they may affect the entity's compliance with many compliance requirements.[3] [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

Assessing Inherent Risk

.19 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess inherent risk by assessing the likelihood and magnitude of noncompliance. In doing so, the auditor should take into account how, and the degree to which, inherent risk factors affect the susceptibility of compliance requirements to noncompliance. [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.20 The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material noncompliance. [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

Assessing Control Risk

.21 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control

[3][Footnote deleted by the issuance of SAS No. 140, April 2020. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

risk at the maximum level such that the assessment of the risk of material noncompliance is the same as the assessment of inherent risk. [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

Performing Further Audit Procedures in Response to Assessed Risks

.22 If the auditor identifies risks of material noncompliance that are pervasive to the entity's compliance, the auditor should develop an overall response to such risks. (Ref: par. .A21) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.23 The auditor should design and perform further audit procedures, including tests of details (which may include tests of transactions) to obtain sufficient appropriate audit evidence about the entity's compliance with each of the applicable compliance requirements in response to the assessed risks of material noncompliance. Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance. (Ref: par. .A22–.A25) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.24 The auditor should design and perform further audit procedures in response to the assessed risks of material noncompliance. These procedures should include performing tests of controls over compliance if

a. the auditor's risk assessment includes an expectation of the operating effectiveness of controls over compliance related to the applicable compliance requirements;

b. substantive procedures alone cannot provide sufficient appropriate audit evidence; or

c. such tests of controls over compliance are required by the governmental audit requirement.

If any of the conditions in this paragraph are met, the auditor should test the operating effectiveness of controls over each applicable compliance requirement to which the conditions apply in each compliance audit. (Ref: par. .A26–.A27) [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

Supplementary Audit Requirements

.25 The auditor should determine whether audit requirements are specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards* and perform procedures to address those requirements, if any. (Ref: par. .A28) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.26 In instances where audit guidance provided by a governmental agency for the performance of compliance audits has not been updated for, or otherwise conflicts with, current GAAS or *Government Auditing Standards,* the auditor should comply with the most current applicable GAAS and *Government Auditing Standards* instead of the outdated or conflicting guidance. (Ref: par. .A29) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Written Representations

.27 The auditor should request from management written representations[4] that are tailored to the entity and the governmental audit requirement: (Ref: par. .A30)

a. acknowledging management's responsibility for understanding and complying with the compliance requirements;

b. acknowledging management's responsibility for the design, implementation, and maintenance of controls that provide reasonable assurance that the entity administers government programs in accordance with the compliance requirements;

c. stating that management has identified and disclosed to the auditor all of its government programs and related activities subject to the governmental audit requirement;

d. stating that management has made available to the auditor all contracts and grant agreements, including amendments, if any, and any other correspondence relevant to the programs and related activities subject to the governmental audit requirement;

e. stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements or stating that there was no such noncompliance;

f. stating whether management believes that the entity has complied with the applicable compliance requirements (except for noncompliance it has disclosed to the auditor);

g. stating that management has made available to the auditor all documentation related to compliance with the applicable compliance requirements;

h. identifying management's interpretation of any applicable compliance requirements that are subject to varying interpretations;

i. stating that management has disclosed to the auditor any communications from grantors and pass-through entities concerning possible noncompliance with the applicable compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditor's report;

j. stating that management has disclosed to the auditor the findings received and related corrective actions taken for previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditor's report;

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[4]See section 580, *Written Representations*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

k. stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements subsequent to the period covered by the auditor's report or stating that there were no such known instances; and

l. stating that management is responsible for taking corrective action on audit findings of the compliance audit.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.28 If the auditor determines that it is necessary to obtain additional representations related to the entity's compliance with the applicable compliance requirements, the auditor should request such additional representations. [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Subsequent Events

.29 The auditor should perform audit procedures up to the date of the auditor's report to obtain sufficient appropriate audit evidence that all subsequent events related to the entity's compliance during the period covered by the auditor's report on compliance have been identified. (Ref: par. .A31) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.30 The auditor should take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which should include, but are not limited to, inquiring of management about and considering

- relevant internal auditors' reports issued during the subsequent period.
- other auditors' reports identifying noncompliance that were issued during the subsequent period.
- reports from grantors and pass-through entities on the entity's noncompliance that were issued during the subsequent period.
- information about the entity's noncompliance obtained through other professional engagements performed for that entity.

[Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.31 The auditor has no obligation to perform any audit procedures related to the entity's compliance during the period subsequent to the period covered by the auditor's report. However, if before the report release date, the auditor becomes aware of noncompliance in the period subsequent to the period covered by the auditor's report that is of such a nature and significance that its disclosure is needed to prevent report users from being misled, the auditor should discuss the matter with management and, if appropriate, those charged with governance, and should include an other-matter paragraph in the auditor's report describing the nature of the noncompliance. (Ref: par. .A32) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: par. .A33–.A34)

.32 The auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained.[5] [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.33 The auditor should form an opinion, at the level specified by the governmental audit requirement, on whether the entity complied in all material respects with the applicable compliance requirements, and report appropriately. In forming an opinion, the auditor should evaluate likely questioned costs, not just known questioned costs, as well as other material noncompliance that, by its nature, may not result in questioned costs. [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Reporting

Combined Report on Compliance and Internal Control Over Compliance

.34 The auditor's combined report on compliance and internal control over compliance should be in writing and include the following:

a. *Title*. The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.

b. *Addressee*. The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement.

c. *Report on compliance.* The report on compliance should be presented before the report on internal control over compliance and include the heading "Report on Compliance."

d. *Opinion.* The first section of the auditor's report on compliance should include the auditor's opinion and section with a heading that includes the word "Opinion" and indicates the reporting level pursuant to the governmental audit requirement. The "Opinion" section of the auditor's report should also do the following (Ref: par. .A36):

   i. State that the entity's compliance with the applicable compliance requirements has been audited

   ii. Identify the applicable compliance requirements or include a reference to where they can be found

   iii. Identify the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information

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[5]Paragraphs .27–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

iv. Specify the period covered by the report

v. When expressing an unmodified opinion, state that, in the auditor's opinion, the entity complied, in all material respects, with the compliance requirements that are applicable to [*indicate the reporting level pursuant to the governmental audit requirement*] for the [*specify the period covered by the report*]

e. *Basis for opinion.* The auditor's report on compliance should include a section, directly following the "Opinion" section, with the heading, "Basis for Opinion," that does the following:

i. States that the audit of compliance was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement

ii. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement

iii. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities in accordance with the relevant ethical requirements relating to the audit[6]

iv. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

v. States that the compliance audit does not provide a legal determination of the entity's compliance with the applicable compliance requirements

f. *Management's responsibilities.* The auditor's report on compliance should include a section with the heading "Responsibilities of Management for Compliance." This section of the auditor's report should describe management's responsibility for compliance with the applicable compliance requirements and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the entity's government programs. If the document containing the auditor's report contains a separate statement by management about its responsibility for the applicable compliance requirements, the auditor's report should not include a reference to such statement by management.

g. *Auditor's responsibilities.* The auditor's report on compliance should include a section with the heading "Auditor's Responsibilities for the Audit of Compliance." This section of the auditor's report should do the following:

[6]See paragraphs .A38–.A39 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

i. State that the objectives of the auditor are to

   1. obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error

   2. express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit

ii. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the governmental audit requirement will always detect material noncompliance when it exists

iii. State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control

iv. State that noncompliance with the applicable compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the government program as a whole

v. Describe an audit by stating that, in performing an audit in accordance with GAAS, *Government Auditing Standards*, and [*insert the name of the governmental audit requirement or program-specific audit guide*] the auditor's responsibilities are to

   1. exercise professional judgment and maintain professional skepticism throughout the audit.

   2. identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the entity's compliance with applicable compliance requirements and performing such other procedures as the auditor considered necessary in the circumstances.

   3. obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [*the governmental audit requirement*], but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.

vi. State that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit[7]

h. If noncompliance that does not result in a modified opinion but is required to be reported by the governmental audit requirement is identified, the auditor's report should include an other-matter paragraph, in a separate section with the heading "Other Matter" or another appropriate heading,[8] that includes a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule. (Ref: par. .A38)

i. *Report on Internal Control Over Compliance.* The auditor's combined report on compliance and internal control over compliance should include a section with the heading "Report on Internal Control Over Compliance" that does the following:

   i. Includes the definitions of *deficiency in internal control over compliance*, *material weakness in internal control over compliance*, and *significant deficiency in internal control over compliance*.

   ii. States that the auditor's consideration of the entity's internal control over compliance was for the limited purpose described in the "Auditor's Responsibilities for the Audit of Compliance" section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Therefore, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

   iii. Describes any identified material weaknesses and significant deficiencies in internal control over compliance or a reference to an accompanying schedule containing such a description.

   iv. If no material weaknesses in internal control over compliance were identified, includes a statement to that effect.

   v. States that the audit was not designed for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.

j. If the criteria used to evaluate compliance are

   i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or

   ii. available only to the specified parties,

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[7][Footnote renumbered and deleted by the issuance of SAS No. 140, April 2020. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

[8]Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

an alert describing the purpose of the auditor's report on compliance and internal control over compliance and that the report is not suitable for any other purpose, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.[9]

k. The manual or printed signature of the auditor's firm.

l. The city and state where the auditor's report is issued.

m. The date of the auditor's report. 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 compliance, including evidence that management has asserted that it has identified the entity's government programs and has taken responsibility for understanding and complying with the compliance requirements. (Ref: par. .A37)

A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (Unmodified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)." [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Separate Reports on Compliance and Internal Control Over Compliance

.35 If the auditor issues separate reports on compliance and internal control over compliance, the separate report on compliance would omit the elements related to internal control over compliance (paragraph .30*i*). The separate report on internal control over compliance would omit the elements related to compliance (paragraph .30*c*–*h*) and would include the following additional statements:

a. A statement that the auditor audited the entity's compliance with applicable compliance requirements pertaining to [*identify the government program or programs and the period audited*] and a reference to the auditor's report on compliance

b. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement

[9] See paragraphs .06*a*–*b*, .11, and .A11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

c. A statement that management is responsible for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs

d. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance

e. A statement that the auditor is not expressing an opinion on internal control over compliance

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

[.36] [Paragraph deleted by the issuance of SAS No. 140, April 2020. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.37 The auditor should report noncompliance as well as other matters that are required to be reported by the governmental audit requirement in the manner specified by the governmental audit requirement. If the other matters required to be reported by the governmental audit requirement are not appropriate for the auditor to report on, the auditor should follow paragraph .43. (Ref: par. .A38) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Other Reporting Considerations

.38 The auditor should modify the auditor's opinion on compliance in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, if any of the following conditions exist:

a. The auditor concludes that, based on the audit evidence obtained, material noncompliance with the applicable compliance requirements exists.

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude whether material noncompliance with the applicable compliance requirements exists.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.39 When noncompliance results in a modified opinion, the "Basis for Opinion" section, with an appropriately modified heading, should include a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule, and a statement that compliance with such requirements is necessary, in the auditor's opinion, for the entity to comply with the applicable compliance requirements.[10] [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.40 The auditor should modify the report described in paragraphs .34–.35 when the auditor makes reference to the report of another auditor as the basis, in part, for the auditor's report. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[.41] [Paragraph renumbered and deleted by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.42 The auditor also should communicate to those charged with governance of the auditor's responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement, an overview of the planned scope and timing of the compliance audit, and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the compliance audit.[11,12] (Ref: par. .A39–.A40) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.43 Printed forms, schedules, or reports designed or adopted by government agencies with which they are to be filed sometimes contain prescribed wording. If a printed form, schedule, or report requires the auditor to make a statement that the auditor has no basis to make, the auditor should accordingly reword the form, schedule, or report or attach an appropriately worded separate report. (Ref: par. .A41) [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

Documentation (Ref: par. .A42)

.44 The auditor should document

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[10]Paragraph .21 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

[11]See section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently [moved and] renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[12]See section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

a. the risk assessment procedures performed, including those related to obtaining an understanding of internal control over compliance, and[13]

b. the identified and assessed risks of material noncompliance, including risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.

[Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.45 The auditor should document the auditor's responses to the assessed risks of material noncompliance, the procedures performed to test compliance with the applicable compliance requirements, and the results of those procedures, including any tests of controls over compliance.[14] [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.46 The auditor should document materiality levels and the basis on which they were determined. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.47 The auditor should document how the auditor complied with the specific governmental audit requirements that are supplementary to GAAS and *Government Auditing Standards*. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

Reissuance of the Compliance Report (Ref: par. .A43–.A44)

.48 If an auditor reissues the auditor's report, the reissued report should include an other-matter paragraph stating that the report is replacing a previously issued report and describing the reasons why the report is being reissued, and any changes from the previously issued report. If additional procedures are performed to obtain sufficient appropriate audit evidence for all of the government programs being reported on, the auditor's report date should be updated to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the events that caused the auditor to perform the new procedures. If, however, additional procedures are performed to obtain sufficient appropriate audit evidence for only some of the government programs being reported on, the auditor should dual date the report with the updated report date reflecting the

[13] Paragraph .42*a*–*c* of section 315. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[14] Paragraph .30 of section 330. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

date the auditor obtained sufficient appropriate audit evidence regarding the government programs affected by the circumstances and referencing the government programs for which additional audit procedures have been performed. Reissuance of an auditor-prepared document required by the governmental audit requirement that is incorporated by reference into the auditor's report is considered to be a reissuance of the report. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

Application and Other Explanatory Material

Introduction and Applicability

.A1 An example of an engagement to which this section is applicable is an audit performed in accordance with the provisions of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). This section is applicable because the Uniform Guidance is a governmental audit requirement that requires the auditor to perform a compliance audit in accordance with both GAAS and *Government Auditing Standards* and to express an opinion on compliance. Another example is a department specific requirement such as the U.S. Department of Housing and Urban Development *Audit Requirements Related to Entities Such As Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders*. An example of an engagement to which this section is not applicable is an engagement performed to satisfy a law or regulation requiring the entity to have an auditor determine whether the entity has spent transportation excise tax monies in accordance with the specific purposes outlined in the law or regulation, but not requiring that the audit be performed in accordance with both GAAS and *Government Auditing Standards*. Such an engagement could be performed under AT-C section 315; AT-C section 205; or AT-C section 215, *Agreed-Upon Procedures Engagements*, depending on the requirements of the government.

Law or regulation will not always indicate which standards to follow. In such cases, professional judgment will be needed to determine, based on the circumstances, the appropriate standards to follow. (Ref: par. .01) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A2 An example of a governmental audit requirement that calls for an examination of an entity's compliance with specified requirements in accordance with AT-C section 315 is the compliance attestation engagement of third-party servicers included in the U.S. Department of Education's audit guide *Guide for Audits of Proprietary Schools and For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs*. (Ref: par. .01 and .03) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Objectives

.A3 Most governmental audit requirements specify that the auditor's opinion on compliance is at the program level. However, some governmental audit requirements may specify a different level (for example, at the applicable compliance requirement level). (Ref: par. .10) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Definitions

Governmental Audit Requirement

.A4 Governmental audit requirements also may set forth specific supplementary requirements of the compliance audit (for example, procedures to be performed by the auditor, documentation requirements, the form of reporting, and continuing professional education requirements with which the auditor is required to comply). (Ref: par. .11) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: par. .12)

.A5 AU-C sections often identify audit procedures and contain examples that are specific to a financial statement audit. The auditor is not expected to adapt or apply all such procedures to the compliance audit, only those that, in the auditor's professional judgment, are relevant and necessary to meet the objectives of the compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Establishing Materiality Levels (Ref: par. .13)

.A6 In a compliance audit, the auditor's purpose for establishing materiality levels is to

a. determine the nature and extent of risk assessment procedures.

b. identify and assess the risks of material noncompliance.

c. determine the nature, timing, and extent of further audit procedures.

d. evaluate whether the entity complied with the applicable compliance requirements.

e. report findings of noncompliance and other matters required to be reported by the governmental audit requirement.

.A7 Generally, for all of the purposes identified in paragraph .A6, the auditor's consideration of materiality is in relation to the government program as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, the Uniform Guidance states that the auditor's determination of whether noncompliance is material for the purpose of reporting an audit finding is in relation to a type of compliance requirements identified in the

OMB *Compliance Supplement* (*Compliance Supplement*). (See paragraph .A10 for further information about the *Compliance Supplement*.) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A8 Because the governmental audit requirement usually is established by the grantors and the auditor's report on compliance is primarily for their use, the auditor's determination of materiality usually is influenced by the needs of the grantors. However, in a compliance audit, the auditor's judgment about matters that are material to users of the auditor's report also is based on consideration of the needs of users as a group, including grantors.

Identifying Government Programs and Applicable Compliance Requirements (Ref: par. .14)

.A9 Some governmental audit requirements specifically identify the applicable compliance requirements. Other governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements. For example, the *Compliance Supplement* provides such a framework for compliance audits under the Uniform Guidance. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A10 The following are some of the sources an auditor may consult when identifying and obtaining an understanding of the applicable compliance requirements:

a. The *Compliance Supplement*, which is issued by the OMB, and used in compliance audits under the Uniform Guidance, contains the compliance requirements that typically are applicable to federal government programs, as well as suggested audit procedures when compliance requirements are applicable and have a direct and material effect on the entity's compliance. Part 7 of the *Compliance Supplement* provides guidance for identifying compliance requirements for programs not included therein.

b. The applicable program-specific audit guide issued by the grantor agency, which contains the compliance requirements pertaining to the government program and suggested audit procedures to test for compliance with the applicable compliance requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A11 The following are procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:

a. Reading laws, statutes, regulations, rules, and provisions of contracts or grant agreements that pertain to the government program

b. Making inquiries of management and other knowledgeable entity personnel (for example, the chief financial officer, internal auditors, legal counsel, compliance officers, or grant or contract administrators)

c. Making inquiries of appropriate individuals outside the entity, such as

    i. the office of the federal, state, or local program official or auditor, or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements

    ii. a third-party specialist, such as an attorney

d. Reading the minutes of meetings of the governing board of the entity being audited

e. Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements

f. Discussing the applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures listed in this paragraph also may assist the auditor in obtaining a further understanding of the applicable compliance requirements even when the *Compliance Supplement* or program-specific audit guide is applicable. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Performing Risk Assessment Procedures (Ref: par. .15–.17)

.A12 Obtaining an understanding of the government program, the applicable compliance requirements, and the entity's internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about identifying and assessing risks of material noncompliance and responding to those risks throughout the compliance audit. The auditor is also responsible for evaluating the audit evidence obtained from the risk assessment procedures and, as applicable, revising the identification or assessment of risks of material noncompliance.[15] [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A13 The nature and extent of the risk assessment procedures the auditor performs may vary from entity to entity and are influenced by factors such as the following:

- The newness and complexity of the applicable compliance requirements
- The auditor's knowledge of the entity's internal control over compliance with the applicable compliance requirements obtained in previous audits or other professional engagements

[15]Paragraphs .39 and .41 of section 315. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

- The nature of the applicable compliance requirements
- The services provided by the entity and how they are affected by external factors
- The level of oversight by the grantor or pass-through entity
- How management addresses findings

.A14 For purposes of GAAS, the system of internal control consists of the following five interrelated components: the control environment, the entity's risk assessment process, the entity's process to monitor the system of internal control, the information system and communication, and control activities.[16]Section 315 contains a detailed discussion of these components.[17] [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A15 Evaluating whether controls that address risks of material noncompliance are effectively designed, and determining whether those controls have been implemented involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material noncompliance as well as establishing that the control exists and that the entity is using it.[18] [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A16 Section 315 includes additional requirements related to control activities related to risks arising from the use of IT that also apply to a compliance audit.[19] [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A17 The auditor's procedures described in paragraph .17, related to understanding how management has responded to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements, are performed to assist the auditor in understanding whether management responded appropriately to such findings. Examples of external monitoring include regulatory reviews,

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[16][Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[17]Paragraphs .21–.26 and .27*b*–.31 and appendix C, "Understanding the Entity's System of Internal Control," of section 315. [Footnote added to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

[18]Paragraph .A105 of section 315. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

[19]Paragraphs .28–.29 of section 315. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

program reviews by government agencies or pass-through entities, and grantor reviews. Examples of internal monitoring include reports prepared by the internal audit function and internal quality assessments. [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .18)

.A18 Inherent risk factors and other considerations in identifying and assessing the risks of material noncompliance may include the following:

- Criteria for identifying and assessing risks of material noncompliance identified by the governmental audit requirement as well as related communications from oversight organizations or regulators
- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor's observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor's assessment of the risks of material misstatement in the financial statement audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A19 The auditor may find it helpful to consider the relevant application material in section 315, adapted as necessary for a compliance audit, when identifying and assessing the risks of material noncompliance.[20] [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A20 Examples of situations in which there may be a risk of material noncompliance that is pervasive to the entity's noncompliance are as follows:

[20] Paragraphs .A235, .A237–.A244, and .A252–.A263 of section 315. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

- An entity that is experiencing financial difficulty and for which there is an increased risk that grant funds will be diverted for unauthorized purposes
- An entity that has a history of poor recordkeeping for its government programs

[Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Performing Further Audit Procedures in Response to Assessed Risks

.A21 Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance that may be adapted when developing an overall response to the risks of material noncompliance.[21] (Ref: par. .22) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A22 A compliance audit includes designing procedures to detect both intentional and unintentional material noncompliance. The auditor can obtain reasonable, but not absolute, assurance about the entity's compliance because of factors such as the need for judgment, the use of sampling, the inherent limitations of internal control over compliance with applicable compliance requirements, and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between entity personnel and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance with applicable compliance requirements exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the auditor. (Ref: par. .23) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A23 An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit. Section 530, *Audit Sampling*, discusses the factors to be considered in planning, designing, and evaluating audit samples, including sampling for tests of controls. In addition, the AICPA Audit Guide Government Auditing Standards *and Single Audits* contains guidance on sampling in the context of a compliance audit. (Ref: par. .23) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A24 To test for compliance with applicable laws and regulations, tests of details (including tests of transactions) may be performed in the following areas:

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[21]Paragraphs .A1–.A3 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

- Grant disbursements or expenditures
- Eligibility files
- Cost allocation plans
- Periodic reports filed with grantor agencies (Ref: par. .23)

[Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A25 The use of substantive analytical procedures to obtain evidence in responding to assessed risks of material noncompliance is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence. (Ref: par. .23) [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

.A26 Section 330 provides guidance related to designing and performing further audit procedures in response to the assessed risks of material noncompliance.[22] However, the paragraphs in section 330 that address the use of audit evidence about the operating effectiveness of controls obtained in prior audits are not applicable to a compliance audit.[23] (Ref: par. .24) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A27 Some governmental audit requirements, for example, in the Uniform Guidance, require tests of the operating effectiveness of controls identified as likely to be effective, even if the auditor believes that such testing would be inefficient. (Ref: par. .24) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Supplementary Audit Requirements

.A28 Examples of supplementary audit requirements are the requirements in the Uniform Guidance for the auditor to

- perform specified procedures to identify major programs.

[22]Paragraphs .06–.12, .15–.18, and .22–.25 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[23]Paragraph .13–.14 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

- follow up on prior audit findings and perform procedures to assess the reasonableness of the summary schedule of prior audit findings. (Ref: par. .25)

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A29 When there is conflicting guidance, the auditor may decide to consult with the government agency responsible for establishing audit guidance or that provides the funding. (Ref: par. .26) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Written Representations

.A30 In some cases, management may include qualifying language in the written representations to the effect that representations are made to the best of management's knowledge and belief. However, such qualifying language is not appropriate for the representations in paragraph .27*a–b* and .27*l*. (Ref: par. .27) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Subsequent Events

.A31 Two types of subsequent events may occur. The first type consists of events that provide additional evidence with respect to conditions that existed at the end of the reporting period that affect the entity's compliance during the reporting period. The second type consists of events of noncompliance that did not exist at the end of the reporting period but arose subsequent to the reporting period. (Ref: par. .29) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A32 An example of a matter of noncompliance that may occur subsequent to the period being audited but before the report release date that may warrant disclosure to prevent report users from being misled is the discovery of noncompliance in the subsequent period of such magnitude that it caused the grantor to stop funding the program. (Ref: par. .31) [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: par. .32–.33)

.A33 In determining whether an entity has materially complied with the applicable compliance requirements, the auditor may consider the following factors:

a. The frequency of noncompliance with the applicable compliance requirements identified during the compliance audit

b. The nature of the noncompliance with the applicable compliance requirements identified

c. The adequacy of the entity's system for monitoring compliance with the applicable compliance requirements and the possible effect of any noncompliance on the entity

d. Whether any identified noncompliance with the applicable compliance requirements resulted in likely questioned costs that are material to the government program

[Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A34 The auditor's evaluation of whether the entity materially complied with applicable compliance requirements includes consideration of noncompliance identified by the auditor, regardless of whether the entity corrected the noncompliance after the auditor brought it to management's attention. [Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

Reporting

[.A35] [Paragraph deleted by the issuance of SAS No. 125, December 2011. Paragraph renumbered by the issuance of SAS No. 148, August 2022.][24]

.A36 An appropriate heading for the "Opinion" section indicates the level specified by the governmental audit requirement. For example, an appropriate heading for reports on compliance audits under the Uniform Guidance would be "Opinion on Each Major Federal Program." (Ref: par. .34*d*) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A37 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[25] When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.[26] (Ref: par. .34*m*) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 148, August 2022.]

.A38 If the report is a matter of public record or available for public inspection, removing personally identifiable information in the compliance audit report and findings of noncompliance will reduce the likelihood of sensitive information being disclosed. (Ref: par. .34*k–m* and .37) [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

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[24][Footnote deleted by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[25]See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

[26]Paragraph .21 of section 220A. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Footnote renumbered by the issuance of SAS No. 148, August 2022.]

.A39 *Government Auditing Standards* also requires the auditor to obtain and report views of responsible officials concerning the findings, conclusions, and recommendations included in the auditor's report as well as any planned corrective actions.[27] (Ref: par. .42) [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.A40 If views of responsible officials are included in the auditor's report or in an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report, the auditor may add a paragraph to the auditor's written communication disclaiming an opinion on management's response. Following is an example of such a paragraph: (Ref: par. .42)

> *Government Auditing Standards* requires the auditor to perform limited procedures on Example Entity's response, described in the accompanying [*insert name of document*], to the [*insert type of findings, such as noncompliance or internal control over compliance*] findings identified in our compliance audit. Example Entity's response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

[Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.A41 If the auditor is submitting a reworded form, schedule, or report or appropriately worded separate report, the auditor may include a separate communication to the agency explaining why the auditor's report was modified. (Ref: par. .43) [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

Documentation (Ref: par. .12 and .44–.47)

.A42 The auditor is not expected to prepare specific documentation of how the auditor adapted and applied each of the applicable AU-C sections to the objectives of a compliance audit. The documentation of the audit strategy, audit plan, and work performed cumulatively demonstrate whether the auditor has complied with the requirement in paragraph .12. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

[27] See the "Reporting Views of Responsible Officials" section of *Government Auditing Standards*. [Footnote renumbered and revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Footnote subsequently renumbered, August 2022, to reflect conforming changes necessary due to the issuance of SAS No. 148]

Reissuance of the Compliance Report (Ref: par. .48)

.A43 The following are examples of situations in which the auditor might reissue the compliance report:

- A quality control review performed by a governmental agency indicates that the auditor did not test an applicable compliance requirement.
- The discovery subsequent to the date of the compliance report that the entity had another government program that was required to be tested.

[Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

.A44 An example of an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report is the schedule of findings and questioned costs in a compliance audit under the Uniform Guidance. [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 148, August 2022.]

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits[1]

.A45 The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (*a*) they are not relevant to a compliance audit environment, (*b*) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (*c*) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor's opinion on compliance.

[1][Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

AU-C Section	Paragraphs Not Applicable to Compliance Audits
210A, *Terms of Engagement*	Paragraphs .06*a* and .08*a*
240, *Consideration of Fraud in a Financial Statement Audit*	Paragraphs .26 and .32*b*
250, *Consideration of Laws and Regulations in an Audit of Financial Statements*	All
315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*	Paragraphs .19*b*, .20, .27*a*, .32–.38, .40, and .42*d*
330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*	Paragraphs .13–.15, .18–.22, .26, and .31–.32
501, *Audit Evidence — Specific Considerations for Selected Items*	All except paragraph .27*
505, *External Confirmations*	All
510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*	Paragraphs .06, .08–.13, and .15–.17
540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*	All
550, *Related Parties*	All
560, *Subsequent Events and Subsequently Discovered Facts*	Paragraphs .09–.11 and .19–.20
570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*	All
600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*	Paragraphs .26, .39, .41*c*, .41*d*, .55, and .56*c*
700, *Forming an Opinion and Reporting on Financial Statements*	Paragraphs .13–.17, .21–.44, and .45–.61
701, *Communicating Key Audit Matters in the Independent Auditor's Report*	All
703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*	All
705, *Modifications to the Opinion in the Independent Auditor's Report*	Paragraphs .18–.20
706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*	Paragraphs .06–.07
708, *Consistency of Financial Statements*	All
720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*	All
725, *Supplementary Information in Relation to the Financial Statements as a Whole*	All
730, *Required Supplementary Information*	All
800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*	All
805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*	All

AU-C Section	Paragraphs Not Applicable to Compliance Audits
806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*	All
810, *Engagements to Report on Summary Financial Statements*	All
910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*	All
915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*	All
920, *Letters for Underwriters and Certain Other Requesting Parties*	All
925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*	All
930, *Interim Financial Information*	All
940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*	All
945, *Auditor Involvement With Exempt Offering Documents*	All
* SAS No. 142, *Audit Evidence* (sec. 500), amended section 501, *Audit Evidence — Specific Considerations for Selected Items*, to add paragraph .27 to section 501. That amendment is effective for audits of financial statements for periods ending on or after December 15, 2022. Consequently, the amendment relating to section 501 in this appendix becomes effective for compliance audits for fiscal periods ending on or after December 15, 2022, to align with the effective date of SAS No. 142. All other revisions to this appendix become effective for compliance audits for fiscal periods ending on or after December 15, 2023.	

[Revised, January 2011, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS Nos. 122 and 123. Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130; Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2022, by SAS No. 148.]

Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — *(Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)*

.A46 The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in paragraph .34. This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide Government Auditing Standards *and Single Audits* contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

<u>Independent Auditor's Report</u>

[*Addressee*]

Report on Compliance

Opinion on [*indicate the reporting level pursuant to governmental audit requirement*]

We have audited Example Entity's compliance with the [*identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements*] applicable to Example Entity's [*identify the government program(s) audited or refer to a separate schedule that identifies the program(s)*] for the year ended June 30, 20X1.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that are applicable to [*indicate the reporting level pursuant to governmental audit requirement*] for the year ended June 30, 20X1.

Basis for Opinion

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards*[1] (*Government Auditing Standards*) issued by the Comptroller General of the United States; and [*insert the name of the governmental audit requirement or program-specific audit guide*]. Our responsibilities under those standards and [*insert the name of the governmental audit requirement or program-specific audit guide*] are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Example Entity's government programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Example Entity's compliance based on our audit.

[1][Footnote deleted by the issuance of SAS No. 140, April 2020.]

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and [*insert the name of the governmental audit requirement or program-specific audit guide*] will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Example Entity's compliance with the requirements of the government program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and [*insert the name of the governmental audit requirement or program-specific audit guide*], we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Example Entity's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Example Entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [*insert the name of the governmental audit requirement or program-specific audit guide*], but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the [*insert the name of the governmental audit requirement or program-specific audit guide*]. Accordingly, this report is not suitable for any other purpose.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2013, to reflect conforming changes necessary due to the issuance of SAS No. 125. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2023, by SAS No. 148.]

AU-C Section 940

An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

Source: SAS No. 130; SAS No. 135; SAS No. 140; SAS No. 145.

Effective for integrated audits for periods ending on or after December 15, 2016, unless otherwise indicated.

Note

In June 2022, the ASB issued SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to this section.

In March 2023, the ASB issued SAS No. 149, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*, which contains amendments to this section.

The amendments are effective for integrated audits for periods ending on or after December 15, 2026, and can be viewed in appendix C of section 600 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting (ICFR) that is integrated with an audit of financial statements (*integrated audit*). (Ref: par. .A1)

.02 Generally accepted auditing standards (GAAS) are written in the context of an audit of financial statements but are to be adapted as necessary in the circumstances when applied to an audit of ICFR that is integrated with an audit of financial statements.[1] This section includes special considerations related to performing an integrated audit.

Effective Date

.03 This section is effective for integrated audits for periods ending on or after December 15, 2016.

Objectives

.04 The objectives of the auditor in an audit of ICFR are to

a. obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment about the effectiveness of ICFR (*as of date*) and

b. express an opinion on the effectiveness of ICFR in a written report, and communicate with management and those charged with governance as required by this section, based on the auditor's findings. (Ref: par. .A2–.A4)

Definitions

.05 For purposes of GAAS, the following terms have the meanings attributed as follows:

Audit of ICFR. An audit of the design and operating effectiveness of an entity's ICFR.

Control objective. The aim or purpose of specified controls. Control objectives address the risks that the controls are intended to mitigate. In the context of ICFR, a control objective generally relates to a relevant assertion for a significant class of transactions, account balance, or disclosure and addresses the risk that the controls in a specific area will not provide reasonable assurance that a misstatement or omission in that relevant assertion is prevented, or detected and corrected, on a timely basis.

Criteria. The benchmarks used to measure or evaluate the subject matter. (Ref: par. .A5)

Detective control. A control that has the objective of detecting and correcting errors or fraud that have already occurred that could result in a misstatement of the financial statements.

Internal control over financial reporting (ICFR). A process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with the applicable financial reporting framework and includes those policies and procedures that

[1] Paragraph .02 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity;

ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the applicable financial reporting framework, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and

iii. provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

ICFR has inherent limitations. ICFR is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. ICFR also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented, or detected and corrected, on a timely basis by ICFR. (Ref: par. .A7–.A8)

Management's assessment about ICFR. Management's conclusion about the effectiveness of the entity's ICFR, based on suitable and available criteria. Management's assessment is included in management's report on ICFR. (Ref: par. .A9)

Preventive control. A control that has the objective of preventing errors or fraud that could result in a misstatement of the financial statements.

Requirements

Preconditions for the Audit of ICFR

.06 Section 210A, *Terms of Engagement*, requires the auditor to establish whether the preconditions for an audit are present.[2] In an audit of ICFR, the auditor should

a. obtain the agreement of management that it acknowledges and understands its responsibility for

   i. designing, implementing, and maintaining effective ICFR.

   ii. evaluating the effectiveness of the entity's ICFR using suitable and available criteria.

   iii. providing management's assessment about ICFR in a report that accompanies the auditor's report (see paragraph .55).

   iv. supporting its assessment about the effectiveness of the entity's ICFR with sufficient evaluations and documentation.

   v. providing the auditor with

[2]Paragraph .06 of section 210A, *Terms of Engagement*.

1. access to all information of which management is aware that is relevant to management's assessment of ICFR, such as records, documentation, and other matters;
2. additional information that the auditor may request from management for the purpose of the audit of ICFR; and
3. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence. (Ref: par. .A10–.A13)

b. determine that the as of date corresponds to the balance sheet date (or period ending date) of the period covered by the financial statements. (Ref: par. .A14)

.07 The auditor should evaluate the effectiveness of the entity's ICFR using the same suitable and available criteria used by management for its assessment. (Ref: par. .A15–.A18)

Requesting a Written Assessment

.08 In accordance with paragraph .06*a*(iii), the auditor should request from management a written assessment about the effectiveness of the entity's ICFR. Management's refusal to provide a written assessment represents a scope limitation, and the auditor should apply the requirements in paragraphs .74–.77.

Integrating the Audit of ICFR With the Financial Statement Audit

.09 Although the objectives of an audit of ICFR and an audit of financial statements are not the same, the auditor should plan and perform the integrated audit to achieve their respective objectives simultaneously. The auditor should design tests of controls

a. to obtain sufficient appropriate audit evidence to support the auditor's opinion on ICFR as of the date specified in management's assessment about ICFR and

b. to obtain sufficient appropriate audit evidence to support the auditor's control risk assessments for purposes of the audit of financial statements. (Ref: par. .A19–.A20)

.10 If the auditor is engaged to audit the effectiveness of an entity's ICFR for a period of time, the requirements and guidance in this section should be modified accordingly, and the auditor should integrate the audit of ICFR with an audit of financial statements covering the same period of time.

.11 The auditor should consider the effect of the results of the financial statement auditing procedures on the auditor's risk assessments and the testing necessary to conclude on the operating effectiveness of a control.

.12 If, during the audit of ICFR, the auditor identifies a deficiency in ICFR, the auditor should determine the effect of the deficiency, if any, on the nature, timing, and extent of substantive procedures to be performed to reduce audit risk in the audit of the financial statements to an acceptably low level. See paragraphs .52–.54 for requirements on evaluating the effects of findings, including those from the financial statement audit, when forming an opinion on the effectiveness of ICFR.

.13 When concluding on the effectiveness of controls for the purpose of the financial statement audit, the auditor should evaluate the results of any additional tests of controls performed by the auditor to achieve the objective related to expressing an opinion on the entity's ICFR. (Ref: par. .A21)

Planning the Audit of ICFR

.14 In accordance with section 300, *Planning an Audit*, the auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit of ICFR and that guides the development of the audit plan.[3] (Ref: par. .A22)

Role of Risk Assessment

.15 The auditor should focus more attention on areas of higher risk. A direct relationship exists between the degree of risk that a material weakness could exist in a particular area of the entity's ICFR and the amount of attention that would be devoted to that area. In addition, an entity's ICFR is less likely to prevent, or detect and correct, a misstatement caused by fraud than a misstatement caused by error. It is not necessary to test controls that, even if deficient, would not present a reasonable possibility of material misstatement to the financial statements. (Ref: par. .A23–.A25)

Addressing the Risk of Fraud

.16 The auditor should evaluate whether the entity's controls sufficiently address identified risks of material misstatement due to fraud and the risk of management override of other controls. (Ref: par. .A26)

.17 Section 240, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.[4] If the auditor identifies deficiencies in controls designed to prevent, or detect and correct, misstatements caused by fraud during the audit of ICFR, the auditor should take into account those deficiencies when developing the response to risks of material misstatement during the financial statement audit.[5]

Using the Work of Internal Auditors or Others

.18 The external auditor should obtain an understanding of the work of the internal audit function and others sufficient to identify those activities related to the effectiveness of ICFR that are relevant to planning and performing the audit of ICFR. (Ref: par. .A27)

.19 The external auditor should evaluate the extent to which the external auditor will use the work of internal auditors or others to modify the nature or timing, or reduce the extent,

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[3]Paragraph .07 of section 300, *Planning an Audit*.

[4]Paragraph .23 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

[5]See paragraphs .28–.33 of section 240.

of audit procedures to be performed directly by the external auditor. When using the work of internal auditors, section 610, *Using the Work of Internal Auditors*, is applicable. When the external auditor plans to use the work of others in obtaining audit evidence or to provide direct assistance in the audit of ICFR, the external auditor should apply the requirements in section 610 as if others were internal auditors. (Ref: par. .A28–.A31)

Materiality

.20 The auditor should use the same materiality for planning and performing the audit of ICFR and the financial statement audit. (Ref: par. .A32)

Using a Top-Down Approach

.21 The auditor should use a top-down approach to the audit of ICFR to select the controls to test. (Ref: par. .A33–.A34)

Entity-Level Controls

.22 The auditor should identify and test those entity-level controls that are important to the auditor's conclusion about whether the entity has effective ICFR. (Ref: par. .A35–.A38)

Evaluating the Components of ICFR

.23 In an integrated audit, the auditor should evaluate the components of ICFR and determine whether

a. the components are present and functioning in the design, implementation, and operation of ICFR, and

b. the components are operating together in an integrated manner to achieve the entity's financial reporting objectives. (Ref: par. .A39–.A49)

Period-End Financial Reporting Process

.24 Because of its importance to financial reporting and to the integrated audit, the auditor should evaluate the period-end financial reporting process, which includes the following:

a. Procedures used to enter transaction totals into the general ledger

b. Procedures related to the selection and application of accounting policies

c. Procedures used to initiate, authorize, record, and process journal entries in the general ledger

d. Procedures used to record recurring and nonrecurring adjustments to the financial statements

e. Procedures for preparing financial statements (Ref: par. .A50)

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

a. the inputs, procedures performed, and outputs of the processes the entity uses to produce its financial statements;

b. the extent of IT involvement in the period-end financial reporting process;

c. who participates from management;

d. the locations involved in the period-end financial reporting process;

e. the types of adjusting and consolidating entries; and

f. the nature and extent of the oversight of the process by management and those charged with governance.

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions

.26 The auditor should identify significant classes of transactions, account balances, and disclosures, and their relevant assertions. To identify significant classes of transactions, account balances, and disclosures, and their relevant assertions, the auditor should evaluate the inherent risk factors[6] related to the financial statement line items and disclosures. (Ref: par. .A51–.A53) [As amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.27 As part of identifying significant classes of transactions, account balances, and disclosures, and their relevant assertions, the auditor should determine the likely sources of potential misstatements that would cause the financial statements to be materially misstated. (Ref: par. .A54–.A55)

.28 When an entity has components, the auditor should identify significant classes of transactions, account balances, and disclosures, and their relevant assertions, based on the group financial statements. (Ref: par. .A56)

Understanding Likely Sources of Misstatement

.29 To further understand the likely sources of potential misstatements, and as a part of selecting the controls to test, the auditor should

a. understand the flow of transactions related to the relevant assertions, including how these transactions are initiated, authorized, recorded, processed, and reported.

b. identify the points within the entity's processes at which a misstatement, including a misstatement due to fraud, could arise that, individually or in combination with other misstatements, would be material (for example, points at which information is initiated, transferred, or otherwise modified).

[6]See paragraph .12 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

c. identify the controls that management has implemented to address these potential misstatements.

d. identify the controls that management has implemented over the prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements. (Ref: par. .A57–.A58)

.30 Because of the degree of judgment necessary, the auditor should either directly perform the procedures that achieve the requirements in paragraph .29 or supervise the work of the internal auditors or others who provide direct assistance to the auditor.

.31 The auditor should understand how IT affects the entity's flow of transactions and, as required by section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the entity's general IT controls that address the risks arising from the use of IT.[7] (Ref: par. .A59) [As amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

Selecting Controls to Test

.32 The auditor should identify and test those controls that are important to the auditor's conclusion about whether the entity's controls sufficiently address the assessed risk of material misstatement to each relevant assertion. (Ref: par. .A60–.A61)

Testing Controls

Evaluating Design Effectiveness

.33 The auditor should evaluate the design effectiveness of controls by determining whether the entity's controls, if operated as prescribed by persons possessing the necessary authority and competence to perform them effectively, satisfy the entity's control objectives, and can effectively prevent, or detect and correct, misstatements caused by errors or fraud that could result in material misstatements in the financial statements. (Ref: par. .A62–.A63)

Testing Operating Effectiveness

.34 The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. (Ref: par. .A64–.A65)

Relationship of Risk to the Evidence to Be Obtained

.35 As the risk associated with the control being tested increases, the sufficiency and appropriateness of evidence that the auditor obtains should also increase. (Ref: par. .A66–.A69)

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[7]Paragraph .26*c* of SAS No. 145. [Footnote renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.36 The auditor should obtain evidence about the effectiveness of selected controls for each relevant assertion. The auditor is not responsible for obtaining sufficient appropriate audit evidence to support an opinion about the effectiveness of each individual control. (Ref: par. .A70–.A76)

.37 To obtain evidence about whether a selected control is effective, the auditor should test the control.

.38 When the auditor identifies control deviations, the auditor should determine the effect of the deviations on the auditor's assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control. (Ref: par. .A77)

Timing and Extent of Tests of Controls

.39 To express an opinion on ICFR as of a point in time, the auditor should obtain evidence that ICFR has operated effectively for a sufficient period of time, which may be less than the entire period (ordinarily one year) covered by the entity's financial statements. The auditor should balance performing the tests of controls closer to the as of date with the need to test controls over a sufficient period of time to obtain sufficient appropriate audit evidence of operating effectiveness. (Ref: par. .A78–.A81)

Rollforward Procedures

.40 When the auditor reports on the effectiveness of controls as of a specific date and obtains evidence about the operating effectiveness of controls at an interim date, the auditor should determine what additional evidence concerning the operation of the controls for the remaining period is necessary. (Ref: par. .A82–.A83)

Special Considerations for Subsequent Years' Audits

.41 In subsequent years' audits, the auditor should incorporate knowledge obtained during past audits performed by the auditor of the entity's ICFR into the decision-making process for determining the nature, timing, and extent of testing necessary. (Ref: par. .A84–.A86)

.42 The auditor should vary the nature, timing, and extent of testing of controls from period to period to introduce unpredictability into the testing and respond to changes in circumstances. (Ref: par. .A87)

Identifying Deficiencies in ICFR

.43 The auditor should determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in ICFR. (Ref: par. .A88)

Determination of Whether Material Weaknesses Exist as of the Date Specified in Management's Assessment About ICFR

.44 For purposes of forming an opinion on the effectiveness of ICFR, the auditor should evaluate the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a material weakness as of the date specified in management's assessment about ICFR. In performing such evaluation, the auditor should determine whether deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR, collectively result in a material weakness. (Ref: par. .A89–.A95)

.45 The auditor should evaluate the effect of compensating controls when determining whether a deficiency, or combination of deficiencies, in ICFR is a material weakness as of the date specified in management's assessment about ICFR. The auditor should test the operating effectiveness of such compensating controls to determine whether they operate at a level of precision that would prevent, or detect and correct, a material misstatement. (Ref: par. .A96)

.46 If the auditor initially determines that a deficiency, or a combination of deficiencies, in ICFR 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. (Ref: par. .A97)

Determination of Whether Significant Deficiencies Exist During the Integrated Audit

.47 The auditor should evaluate the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a significant deficiency. In performing such evaluation, the auditor should determine whether deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR collectively result in a significant deficiency. (Ref: par. .A98–.A99)

Subsequent Events

.48 The auditor should inquire of management and, when appropriate, those charged with governance, about whether there were any changes in ICFR or conditions that might significantly affect ICFR subsequent to the as of date but before the date of the auditor's report. To obtain additional information about changes in ICFR or other conditions that might significantly affect the effectiveness of the entity's ICFR, the auditor should inquire about and read, for this subsequent period, the following: (Ref: par. .A100)

a. Relevant internal audit (or similar functions, such as loan review in a financial institution) reports issued during the subsequent period

b. Reports regarding deficiencies issued by other independent auditors

c. Regulatory agency reports on the entity's ICFR

d. Information about the effectiveness of the entity's ICFR obtained through other engagements performed for the entity by the auditor

.49 If, as a result of the subsequent events procedures, the auditor obtains knowledge about a material weakness that existed as of the date specified in management's assessment about ICFR, the auditor should issue an adverse opinion, as required by paragraph .68. The auditor should also follow paragraph .72 if management's assessment about ICFR states that ICFR is effective. If the auditor is unable to determine the effect of the subsequent event on the effectiveness of the entity's ICFR as of the date specified in management's assessment about ICFR, the auditor should disclaim an opinion. The auditor should disclaim an opinion on management's disclosures about corrective actions taken by the entity, if any. (Ref: par. .A101)

.50 If the auditor obtains knowledge about conditions that did not exist at the as of date but arose subsequent to that date and before the release of the auditor's report and such subsequent information has a material effect on the entity's ICFR, the auditor should include in the auditor's report an emphasis-of-matter paragraph directing the reader's attention to the subsequently discovered fact and its effects as disclosed in management's report or an other-matter paragraph describing the subsequently discovered fact and its effects. (Ref: par. .A102)

.51 The auditor has no responsibility to keep informed of events subsequent to the date of the auditor's report; however, the auditor should respond appropriately to 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.

Concluding Procedures

Forming an Opinion

.52 The auditor should form an opinion on the effectiveness of ICFR by evaluating evidence obtained from all sources, including

a. the auditor's testing of controls for the ICFR audit,

b. any additional tests of controls performed to achieve the objective related to expressing an opinion on the financial statements,

c. misstatements detected during the financial statement audit, and

d. any identified deficiencies.

.53 As part of evaluating evidence obtained from all sources, the auditor should review reports issued during the year by the internal audit function (or similar functions) that address controls related to ICFR and evaluate deficiencies identified in those reports.

.54 In addition to evaluating the findings from the auditor's testing of controls for the audit of ICFR, the auditor should evaluate the effect of the findings of the substantive procedures performed in the audit of financial statements on the effectiveness of ICFR. This evaluation should include, at a minimum,

a. the risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud;

b. findings with respect to noncompliance with laws and regulations;

c. findings with respect to related party transactions and complex or unusual transactions;

d. indications of management bias in making accounting estimates and selecting accounting principles; and

e. the nature and extent of misstatements detected by substantive procedures.

.55 After forming an opinion on the effectiveness of the entity's ICFR, the auditor should evaluate management's report, which will accompany the auditor's report, to determine whether it contains the following:

a. A statement regarding management's responsibility for ICFR

b. A description of the subject matter of the audit (for example, controls over the preparation of the entity's financial statements in accordance with accounting principles generally accepted in the United States of America)

c. An identification of the criteria against which ICFR is measured

d. Management's assessment about ICFR

e. A description of the material weakness(es), if any

f. The date as of which management's assessment about ICFR is made

.56 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. (Ref: par. .A103)

Obtaining Written Representations

.57 In an audit of ICFR, the auditor should obtain written representations from management

a. acknowledging management's responsibility for designing, implementing, and maintaining effective ICFR;

b. stating that management has performed an assessment of the effectiveness of the entity's ICFR and specifying the criteria;

c. stating that management did not use the auditor's procedures performed during the integrated audit as part of the basis for management's assessment about ICFR;

d. stating management's assessment about the effectiveness of the entity's ICFR based on the criteria as of a specified date;

e. stating that management has disclosed to the auditor all deficiencies in the design or operation of ICFR, including separately disclosing to the auditor all such deficiencies that it believes to be significant deficiencies or material weaknesses;

f. describing any fraud resulting in a material misstatement to the entity's financial statements and any other fraud that does not result in a material misstatement to the entity's financial statements, but involves senior management or management or other employees who have a significant role in the entity's ICFR;

g. stating whether the significant deficiencies and material weaknesses identified and communicated to management and those charged with governance during previous engagements pursuant to paragraph .59 have been resolved and specifically identifying any that have not; and

h. stating whether there were, subsequent to the date being reported on, any changes in ICFR or other conditions that might significantly affect ICFR, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses (Ref: par. .A104)

[As amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.58 If management does not provide the written representations required by paragraph .57, the auditor should apply the requirements in paragraph .73. (Ref: par. .A105)

Communicating ICFR-Related Matters

.59 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. (Ref: par. .A106–.A108)

.60 If the auditor concludes that the oversight of the entity's financial reporting and ICFR by the audit committee (or similar subgroups with different names) is ineffective, the auditor should communicate that conclusion in writing to the board of directors or other similar governing body.

.61 The written communications referred to in paragraphs .59–.60 should be made by the report release date, which is the date the auditor grants the entity permission to use the auditor's report. For a governmental entity, if such written communications would be publicly available prior to management's report on ICFR, the entity's financial statements, and the auditor's report thereon, the auditor is not required to make the written communications by the report release date. In that circumstance, the written communications should be made as soon as practicable, but no later than 60 days following the report release date. (Ref: par. .A109–.A110)

.62 The auditor should communicate in writing to management all deficiencies identified during the integrated audit on a timely basis, but no later than 60 days following the report release date, and inform those charged with governance when such a communication was or is expected to be made. In making the written communication referred to in this paragraph, 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. (Ref: par. .A111–.A113)

.63 Because the integrated audit does not provide the auditor with reasonable assurance that the auditor has identified all deficiencies less severe than a material weakness, the auditor should not issue a report stating that no such deficiencies were identified during the integrated audit. Also, because the auditor issues a report that expresses an opinion on the effectiveness of the entity's ICFR, the auditor should not issue a report indicating that no material weaknesses were identified during the integrated audit.

Reporting on ICFR

.64 The auditor's report on the audit of ICFR should be in writing and should include the following:

a. *Title*. The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.

b. *Addressee*. The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement.

c. *Auditor's opinion on ICFR*. The first section of the auditor's report should include the auditor's opinion on ICFR and should have the heading "Opinion on Internal Control Over Financial Reporting." The "Opinion on Internal Control Over Financial Reporting" section of the auditor's report should also do the following:

    i. Identify the entity whose ICFR has been audited

    ii. State that the entity's ICFR has been audited

    iii. Identify the as of date

    iv. Identify the criteria against which ICFR is measured

    v. Include the auditor's opinion on whether the entity maintained, in all material respects, effective ICFR as of the specified date, based on the criteria

d. *Basis for opinion*. The auditor's report should include a section, directly following the "Opinion on Internal Control Over Financial Reporting" section, with the heading "Basis for Opinion," that does the following:

    i. States that the audit was conducted in accordance with GAAS and identifies the United States of America as the country of origin of those standards (Ref: par. .A114)

    ii. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS

    iii. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit[8]

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[8]See paragraphs .A38–.A39 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Footnote renumbered by the issuance of SAS No. 145, October 2021.]

   iv. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

e. *Responsibilities of management*. The auditor's report should include a section with the heading "Responsibilities of Management for Internal Control Over Financial Reporting." This section of the auditor's report should do the following:

   i. State that management is responsible for designing, implementing, and maintaining effective ICFR

   ii. State that management is responsible for its assessment about the effectiveness of ICFR

   iii. Include a reference to management's report on ICFR

f. *Auditor's responsibilities*. The auditor's report should include a section with the heading "Auditor's Responsibility for the Audit of Internal Control Over Financial Reporting." This section of the auditor's report should do the following:

   i. State that the objectives of the auditor are to

      1. obtain reasonable assurance about whether effective ICFR was maintained in all material respects

      2. issue an auditor's report that includes the auditor's opinion on ICFR

   ii. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists

   iii. Describe the audit by stating that, in performing an audit of ICFR in accordance with GAAS, the auditor's responsibilities are to

      1. exercise professional judgment and maintain professional skepticism throughout the audit

      2. obtain an understanding of ICFR, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of ICFR based on the assessed risk

Definition and Inherent Limitations of Internal Control Over Financial Reporting

g. The auditor's report should include a section with the heading "Definition and Inherent Limitations of Internal Control Over Financial Reporting" or other appropriate heading that includes the following:

   i. A definition of ICFR (the auditor should use the same description of the entity's ICFR as management uses in its report)

   ii. A paragraph stating that because of inherent limitations, ICFR may not prevent, or detect and correct, misstatements and that projections of any assessment of effectiveness to future periods are 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

h. *Signature of the auditor*. The auditor's report should include the manual or printed signature of the auditor's firm.

i. *Auditor's address*. The auditor's report should name the city and state where the auditor's report is issued.

j. *Date of the auditor's report*. The auditor's report should be dated, as required by paragraph .66

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Separate Report on ICFR

.65 If the auditor issues a separate report on ICFR, the auditor should add the following paragraph, following the opinion paragraph within the "Opinion" section, to the auditor's report on the financial statements:

> We also have audited, in accordance with auditing standards generally accepted in the United States of America, [*entity name*]'s internal control over financial reporting as of December 31, 20X8, based on [*identify criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinion*].
>
> The auditor also should add the following paragraph, following the opinion paragraph within the "Opinion on Internal Control Over Financial Reporting" section, to the report on ICFR:
>
> We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of [*entity name*] and our report dated [*date of report, which should be the same as the date of the report on ICFR*] expressed [*include nature of opinion*]. (Ref: par. .A116–.A118)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Report Date

.66 The auditor should date the report on ICFR no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion. Because the audit of ICFR is integrated with the audit of the financial statements, when issuing separate reports on the entity's financial statements and on ICFR, the dates of the reports should be the same. (Ref: par. .A118) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Report Modifications

.67 The auditor should modify the report on ICFR if any of the following conditions exist:

a. One or more material weaknesses exist.

b. Elements of management's report are incomplete or improperly presented.

c. There is a limitation on the scope of the engagement. (Ref: par. .A119)

d. The auditor decides to refer to the report of a component auditor as the basis, in part, for the auditor's own opinion.

e. There is other information contained in management's report.

Adverse Opinions

.68 If there are deficiencies that, individually or in combination, result in one or more material weaknesses as of the date specified in management's assessment about ICFR, the auditor should express an adverse opinion on the entity's ICFR, unless there is a limitation on the scope of the engagement. (Ref: par. .A120–.A121)

.69 The auditor should determine the effect an adverse opinion on ICFR has on the auditor's opinion on the financial statements. Additionally, the auditor should disclose, as a separate paragraph within the "Adverse Opinion on Internal Control Over Financial Reporting" section to the report, whether the auditor's opinion on the financial statements was affected by the material weakness. (Ref: par. .A123) Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.70 When ICFR is not effective because one or more material weaknesses exist, the auditor's report should include the following in the "Basis for Adverse Opinion on Internal Control Over Financial Reporting" section:

a. The definition of a material weakness

b. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR. (Ref: par. .A122)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.71 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. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Elements of Management's Report Are Incomplete or Improperly Presented

.72 If the auditor determines that any required element of management's report, as described in paragraph .55, is incomplete or improperly presented and management does not revise its report, the auditor should modify the report on ICFR to include an other-matter paragraph describing the reasons for this determination. If the auditor determines that the required disclosure about one or more material weaknesses is not fairly presented in all material respects, the auditor should apply the requirements in paragraph .71.

Scope Limitations

.73 If, after accepting the integrated audit engagement, there is a limitation on the scope of the engagement with respect to ICFR, the auditor should withdraw from the integrated audit engagement or disclaim an opinion on ICFR and consider the implications on the financial statement audit.

.74 When a scope limitation arises because management refuses to furnish a written assessment about the effectiveness of ICFR, 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 ICFR and consider the implications on the financial statement audit. (Ref: par. .A124)

.75 When disclaiming an opinion because of a scope limitation, the auditor should state that the auditor does not express an opinion on the effectiveness of ICFR within the "Disclaimer of Opinion on Internal Control Over Financial Reporting" section and state the substantive reasons for the disclaimer within the "Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting" section. The auditor should amend the basis of opinion and auditor's responsibilities sections and should not identify the procedures that were performed nor include the statements describing the characteristics of an audit of ICFR, as described in paragraph .64*d*(i), paragraph .64*d*(ii), paragraph .64*d*(iv), and paragraph .64*f*; to do so might overshadow the disclaimer. (Ref: par. .A125–.A126) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.76 When the auditor disclaims an opinion but has concluded that one or more material weaknesses exist, the auditor's report also should include the following:

a. The definition of a material weakness.

b. A statement that if one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective.

c. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR.

d. A description of the material weaknesses identified in the entity's ICFR. This description should provide the users of the report with specific information about the nature of any material weakness and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the weakness.

The auditor also should apply the requirements in paragraphs .69 and .71. (Ref: par. .A127) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.77 If the auditor concludes that the auditor cannot express an opinion because there has been a limitation on the scope of the audit, the auditor should communicate, in writing, to management and those charged with governance that the audit of ICFR cannot be satisfactorily completed.

Making Reference to a Component Auditor and Assuming Responsibility for the Work of a Component Auditor

.78 When an entity includes one or more components, the group engagement partner should evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or making reference to the audit of ICFR of a component auditor in the auditor's report) to act as the auditor of the ICFR over the group financial statements and report as such on the ICFR over the group financial statements, as required by section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.[9] (Ref: par. .A128)

.79 As required by section 600A, the group engagement partner should determine whether to make reference to a component auditor in the report on the ICFR over the group financial statements.[10] Reference to the audit of a component auditor in the auditor's report on the ICFR over the group financial statements should not be made unless

[9]Paragraph .14 of section 600A, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[10]Paragraph .24 of section 600A. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

a. the engagement partner has determined that the component auditor has performed an audit of the component's ICFR in accordance with the relevant requirements of GAAS (or, if applicable, the standards promulgated by the PCAOB) and

b. the component auditor has issued an auditor's report on ICFR that is not restricted as to use. (Ref: par. .A129–.A130)

Additional Information

.80 When management includes, either within management's report or in a document containing management's report and the related auditor's report, information in addition to the elements that are subject to the auditor's evaluation as described in paragraph .55, the auditor should do the following: (Ref: par. .A131–.A132)

a. Read the additional information to identify material inconsistencies with management's report and remain alert for material misstatements of fact while reading the additional information.

b. If the auditor identifies a material inconsistency or becomes aware of a material misstatement of fact, request management to correct the information, and to do the following, as applicable:

   i. If management agrees to make the correction, determine that the correction has been made.

   ii. If management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made.

   iii. If the correction is not made after communicating with those charged with governance, the auditor should do one or more of the following:

      1. Consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the material inconsistency or material misstatement of fact in the auditor's report

      2. Withhold the auditor's report

      3. Withdraw from the engagement, when withdrawal is possible under the applicable law or regulation

c. When the additional information subject to the requirements of paragraph .80*a* is included in management's report and no material inconsistencies or material misstatements of fact are identified, the auditor should disclaim an opinion, in an other-matter paragraph, on the additional information.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Special Topics

Entities With Multiple Components

.81 In determining the components at which to perform tests of controls, the group engagement team should assess the risk of material misstatement to the financial statements associated with the component and correlate the amount of attention devoted to the component with the degree of risk. (Ref: par. .A133–.A135)

.82 In assessing and responding to risk, the group engagement team should test, or have a component auditor test on the group engagement team's behalf, controls over specific risks that present a reasonable possibility of material misstatement to the group financial statements. (Ref: par. .A136)

.83 In applying the requirement in paragraph .42 regarding special considerations for subsequent years' audits, the group engagement team should vary the nature, timing, and extent of tests of controls at components from year to year.

Special Situations

.84 For equity method investment components, the scope of the audit should include controls over the reporting in the entity's financial statements of the entity's portion of the investees' income or loss, the investment balance, adjustments to the income or loss and investment balance, and related disclosures, in accordance with the applicable financial reporting framework. (Ref: par. .A137)

.85 Except as indicated in paragraph .86, the scope of the audit should include entities that are acquired on or before the date specified in management's assessment about ICFR and operations that are accounted for as discontinued operations on the date specified in management's assessment about ICFR that are reported in accordance with the applicable financial reporting framework in the entity's financial statements.

.86 In situations in which management elects to limit its assessment by excluding certain entities, the auditor should evaluate whether it is appropriate, in the auditor's judgment, to do so. If the auditor concludes that it is appropriate, the auditor should include in either the "Opinion on Internal Control Over Financial Reporting" or "Basis or Opinion" section of the report a disclosure similar to management's regarding the exclusion of an entity from the scope of both management's assessment about ICFR and the auditor's audit of ICFR. Additionally, the auditor should evaluate the appropriateness of management's disclosure related to such a limitation. (Ref: par. .A138) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.87 If the auditor believes that management's disclosure about the limitation requires modification, the auditor should communicate the matter to the appropriate level of management. If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform those charged with governance of the matter as soon as practicable. If management and those charged with governance do not respond appropriately, the auditor should modify the auditor's report on the audit of ICFR to include an other-matter paragraph describing the reasons why the auditor believes management's disclosure requires modification.

Use of Service Organizations

.88 When the entity uses the services of a service organization, the auditor should consider the activities of the service organization when determining the evidence required to support the auditor's opinion on the effectiveness of an entity's ICFR. (Ref: par. .A139–.A140)

.89 The auditor is required to perform the procedures in section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, with respect to the activities performed by the service organization.[11] In an audit of ICFR, the auditor should also obtain evidence that controls at the service organization that are relevant to the auditor's opinion on ICFR are operating effectively. (Ref: par. .A141–.A142)

.90 If the auditor plans to use a type 2 report as audit evidence that controls are operating effectively, the auditor should determine whether the type 2 report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the auditor's opinion by evaluating

a. the time period covered by the tests of controls and its relation to the as of date;

b. the scope of the service auditor's work and the services and processes covered, the controls tested, and the tests that were performed and the way in which tested controls relate to the entity's controls; and

c. the results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls. (Ref: par. .A143)

.91 The auditor should determine whether complementary user entity controls identified in the type 2 report are relevant in addressing the risks of material misstatement and, if so, evaluate the entity's design and implementation of the relevant complementary user entity controls and test their operating effectiveness. (Ref: par. .A144)

.92 In determining whether the type 2 report provides sufficient appropriate audit evidence to support the auditor's opinion on ICFR, the auditor should be satisfied regarding the following:

a. The service auditor's professional competence and independence from the service organization. (Ref: par. .A145)

b. The adequacy of the standards under which the type 2 report was issued. (Ref: par. .A146)

.93 The auditor should inquire of management to determine whether management has identified any changes in the service organization's controls subsequent to the period

[11]Paragraphs .09–.19 of section 402, *Audit Considerations Relating to an Entity Using a Service Organization*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

covered by the service auditor's report. If management has identified such changes, the auditor should evaluate the effect of such changes on the effectiveness of the entity's ICFR. The auditor also should evaluate whether the results of other procedures the auditor performed indicate that there have been changes in the controls at the service organization. (Ref: par. .A147)

.94 The auditor should determine whether to obtain additional evidence about the operating effectiveness of controls at the service organization based on the procedures performed by management or the auditor and the results of those procedures and on an evaluation of the following risk factors:

a. The elapsed time between the time period covered by the tests of controls in the service auditor's report and the as of date

b. The significance of the activities of the service organization

c. Whether there are errors that have been identified in the service organization's processing

d. The nature and significance of any changes in the service organization's controls identified by management or the auditor (Ref: par. .A148)

.95 When a significant period of time has elapsed between the time period covered by the tests of controls in the service auditor's report and the as of date, additional procedures should be performed to obtain sufficient appropriate audit evidence about the operating effectiveness of the controls at the service organization that are relevant to the auditor's opinion on ICFR.

.96 The auditor should not refer to the service auditor's report when expressing an opinion on ICFR.

Benchmarking of Automated Controls

.97 To determine whether to use a benchmarking strategy for testing an automated application control, the auditor should assess the following risk factors:

a. The extent to which the application control can be matched to a defined program within an application

b. The extent to which the application is stable (that is, there are few changes from period to period)

c. The availability and reliability of a report of the compilation dates of the programs placed in production (Ref: par. .A149–.A152)

.98 When using a benchmarking strategy, the auditor should obtain evidence to determine that the automated application control has not changed. (Ref: par. .A153–.A154)

.99 After a period of time, the length of which depends upon the circumstances, the baseline of the operation of an automated application control should be reestablished. To determine when to reestablish a baseline, the auditor should evaluate the following factors:

a. The effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls, and computer operations

b. The auditor's understanding of the nature of changes, if any, on the specific programs that contain the controls

c. The nature and timing of other related tests

d. The consequences of errors associated with the application control that was benchmarked

e. Whether the control is sensitive to other business factors that may have changed (Ref: par. .A155)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Certain regulatory bodies, such as the FDIC, require the audit of ICFR and the audit of financial statements to be performed by the same auditor.[12] Inherent difficulties exist when integrating the audit of ICFR and the audit of the financial statements to meet the requirements of this section when the audit of the financial statements is performed by a different auditor. Nonetheless, if the audit of the financial statements and the audit of ICFR are performed by different auditors, the audits are required by this section to be integrated.

Objectives (Ref: par. .04)

.A2 See section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for additional explanation related to the auditor's objective to obtain reasonable assurance.[13]

.A3 Effective ICFR provides an entity with reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with the applicable financial reporting framework. If one or more material weakness exists, the entity's ICFR cannot be considered effective. The evaluation of the effectiveness of the entity's ICFR required by this section encompasses all relevant control objectives of the entity's ICFR; therefore, the identification of one material weakness in ICFR does not

[12]See Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36 of the Federal Deposit Insurance Act [FDI Act], 12.U.S.C. 1831m) and its implementing regulation, 12 CFR Part 363.3(b). [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[13]Paragraph .06 of section 200. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

justify the auditor ceasing to perform procedures to evaluate the effectiveness of all relevant control objectives of the entity's ICFR.

.A4 The auditor is not required to plan and perform the integrated audit to identify deficiencies that, individually or in combination, are less severe than a material weakness.

Definitions (Ref: par. .05)

Criteria

.A5 For purposes of this section, the subject matter is ICFR.

Internal Control Over Financial Reporting

.A6 For purposes of a financial statement audit, SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, defines the term system of internal control and recognizes that internal control frameworks may use different terms that are similar to the concept of the system of internal control. This section defines the term internal control over financial reporting, which is a system of internal control that supports the preparation of reliable financial statements, to more clearly define ICFR for purposes of expressing an opinion on the effectiveness of ICFR, based on suitable and available criteria. [Paragraph added, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.A7 The auditor's procedures performed as part of the integrated audit are not part of an entity's ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A8 For insured depository institutions (IDIs) subject to the internal control reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), ICFR includes controls over the preparation of the IDI's financial statements in accordance with generally accepted accounting principles (GAAP) and with the instructions to the Consolidated Financial Statements for Bank Holding Companies. ICFR also includes controls over the preparation of the IDI's financial statements in accordance with GAAP and controls over the preparation of schedules equivalent to the basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (Call Report Instructions). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Management's Assessment About ICFR

.A9 Exhibit C, "Illustrative Management Report," includes an illustration of a management report. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Preconditions for the Audit of ICFR (Ref: par. .06–.07)

.A10 Management is responsible for identifying and documenting the controls and the control objectives that they were designed to achieve. Such documentation serves as a basis for management's assessment about ICFR. Documentation of the design of controls, including changes to those controls, is evidence that controls upon which management's assessment about ICFR is based are

- identified.
- capable of being communicated to those responsible for their performance.
- capable of being monitored and evaluated by the entity.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A11 Management's documentation may take various forms, for example, entity policy manuals, accounting manuals, narrative memoranda, flowcharts, decision tables, procedural write-ups, or completed questionnaires. No one particular form of documentation is prescribed, and the extent of documentation may vary depending upon the size and complexity of the entity and the entity's monitoring activities. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A12 Management's monitoring activities also may provide evidence of the design and operating effectiveness of ICFR in support of management's assessment about ICFR. Monitoring of controls is a process to assess the effectiveness of ICFR performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing evaluations, separate evaluations, or a combination of the two. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A13 Ongoing evaluations are often built into the normal recurring activities of an entity and include regular management and supervisory activities. The greater the degree and effectiveness of ongoing evaluations, the less need for separate evaluations. Management may perform a combination of ongoing and separate evaluations. The scope and frequency of separate evaluations is a matter of management judgment. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A14 Ordinarily, the auditor is engaged to audit the effectiveness of the entity's ICFR as of the end of the entity's fiscal year; however, management may select a different date. If the auditor is engaged to audit the effectiveness of an entity's ICFR at a date different from the end of the entity's fiscal year, the audit is, nevertheless, required by paragraph .06*b* to be integrated with a financial statement audit as of the date specified in management's assessment. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A15 Appropriate criteria are both suitable and available to the intended users of management's report on ICFR. Suitable criteria exhibit all of the following characteristics:

- *Relevance*. Criteria are relevant to ICFR.
- *Objectivity*. Criteria are free from bias.

- *Measurability*. Criteria permit reasonably consistent measurements, qualitative or quantitative, of ICFR.
- *Completeness*. Criteria are complete when the evaluation of the effectiveness of ICFR prepared in accordance with the criteria does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of management's report on ICFR.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A16 Management may select criteria for ICFR that are available publicly in published frameworks or criteria that are available only to specified parties (for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry). When criteria are available only to specified parties, section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, requires that the auditor's report include an other-matter paragraph that restricts the use of the auditor's report.[13] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A17 *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO framework) and the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book), provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's ICFR. If management selects another framework, see paragraph .A15 for guidance on evaluating the suitability of the framework selected by management. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A18 *Internal control*, as defined by the framework used by management, may be more broadly defined than ICFR. However, this section focuses only on ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Integrating the Audit of ICFR With the Financial Statement Audit (Ref: par. .09–.13)

.A19 Obtaining sufficient appropriate audit evidence to support the operating effectiveness of controls for purposes of the financial statement audit ordinarily allows the auditor to modify the substantive procedures that otherwise would have been necessary to opine on the financial statements. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A20 Section 500, *Audit Evidence*, provides additional explanation with respect to obtaining sufficient appropriate audit evidence. [Revised, December 2022, to reflect conforming changes necessary due to the issuance of SAS No. 142. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

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[13]Paragraph .06 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A21 Consideration of the results of tests of controls may cause the auditor to alter the nature, timing, and extent of substantive procedures and to plan and perform further tests of controls, particularly in response to identified deficiencies. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Planning the Audit of ICFR (Ref: par. .14)

.A22 Evaluating whether the following matters are important to the entity's financial statements and ICFR and, if so, how they may affect the auditor's procedures may assist the auditor in planning the audit of ICFR:

- Knowledge of the entity's ICFR obtained during other engagements performed by the auditor or, if applicable, during a review of a predecessor auditor's working papers
- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, and capital structure
- The extent of recent changes, if any, in the entity, its operations, or its ICFR
- The auditor's preliminary judgments about financial statement materiality, risk, and other factors relating to the determination of material weaknesses
- Deficiencies previously communicated to those charged with governance or management
- Legal or regulatory matters of which the entity is aware
- The type and extent of available evidence related to the effectiveness of the entity's ICFR
- Preliminary judgments about the effectiveness of ICFR
- Public information about the entity relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the entity's ICFR
- Knowledge about risks related to the entity evaluated as part of the auditor's procedures regarding acceptance or continuance of the client relationship or the integrated audit engagement
- The relative complexity of the entity's operations

[Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

Role of Risk Assessment (Ref: par. .15)

.A23 Risk assessment underlies the entire audit process described by this section, including the determination of significant classes of transactions, account balances, and disclosures, and their relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control. The risk assessment procedures described in section 315 support both the financial statement audit and the audit of ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Scaling the Audit

.A24 The size and complexity of the entity, its business processes, and structure may affect the way in which the entity achieves many of its control objectives. Many smaller entities have less complex operations. Additionally, some larger, complex entities may have less complex units or processes. Factors that might indicate less complex operations include fewer business lines; less complex business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control. Accordingly, a smaller, less complex entity, or even a larger, less complex entity might achieve its control objectives differently from a more complex entity. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A25 The size and complexity of the entity, its business processes, and structure also may affect the auditor's risk assessment and the determination of the necessary procedures and the controls necessary to address those risks. Scaling is most effective as a natural extension of the risk-based approach and applicable to audits of all entities. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Addressing the Risk of Fraud (Ref: par. .16–.17)

.A26 Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud.[15] Controls that might address these risks include

- controls over significant unusual transactions, particularly those that result in late or unusual journal entries;
- controls over journal entries and adjustments made in the period-end financial reporting process;
- controls over related party transactions;
- controls related to significant accounting estimates; and
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results.

[Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

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[15] Paragraphs .25–.27 of section 240. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Using the Work of Internal Auditors or Others (Ref: par. .18–.19)

.A27 The extent of the procedures necessary to obtain the understanding required by paragraph .18 will vary, depending on the nature of those activities. In performing risk assessment procedures, the auditor is required to inquire of appropriate individuals within the internal audit function (if such function exists).[16]SAS No. 145 provides guidance with respect to such inquiries and certain additional procedures based on the responses to such inquiries.[17] [Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.A28 In an audit of ICFR, the external auditor may use the work of the internal audit function in obtaining audit evidence or use internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor. For purposes of the audit of ICFR, however, the auditor also may use the work performed by, or receive direct assistance from, others. Others include entity personnel (in addition to internal auditors) and third parties working under the direction of management or those charged with governance that provide evidence about the effectiveness of ICFR. In an integrated audit, the auditor also may use the work of internal auditors or others to obtain evidence supporting the assessment of control risk for purposes of the financial statement audit. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A29 As the risk associated with a control increases, the need for the auditor to directly perform work on the control increases (for example, for controls that address specific fraud risks, use of the work of the internal audit function or others would be limited, if it could be used at all). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A30 For purposes of evaluating the competence and objectivity of others in accordance with section 610, *competence* means the attainment and maintenance of a level of understanding, knowledge, and skills that enables that person to ably perform the tasks assigned to them, and *objectivity* means the ability to perform those tasks impartially and with intellectual honesty, without allowing bias, conflict of interest, or undue influence of others to override professional judgments.[18] The more objective and the higher level of competence, the more likely the external auditor may use the work of others and make use of it in more areas. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A31 Others may have an approach that differs from that of an internal audit function, particularly with respect to the level of formality. However, it would be inappropriate to use the work of others that do not have a systematic and disciplined approach, including quality control, as required by section 610. Section 610 provides additional requirements

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[16]Paragraph .14 of SAS No. 145. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

[17]Paragraphs .A25 and appendix D of SAS No. 145. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

[18]Paragraphs .13 and .A5–.A9 of section 610, *Using the Work of Internal Auditors*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

and guidance in determining when to use the work, in which areas, and to what extent. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Materiality (Ref: par. .20)

.A32 Section 320, *Materiality in Planning and Performing an Audit*, provides additional explanation of materiality. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Using a Top-Down Approach (Ref: par. .21)

.A33 The *top-down approach* describes the auditor's sequential thought process in identifying risks and the controls to test, not necessarily the order in which the auditor will perform the audit procedures. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A34 A top-down approach involves

- beginning at the financial statement level;
- using the auditor's understanding of the overall risks to ICFR;
- focusing on entity-level controls, which may be indirect [19] or direct controls [20] as described in SAS No. 145;
- working down to significant classes of transactions, account balances, and disclosures, and their relevant assertions, which directs attention to classes of transactions, accounts, disclosures, and assertions that present a reasonable possibility of material misstatement of the financial statements;
- verifying the auditor's understanding of the risks in the entity's processes; and
- selecting controls for testing that sufficiently address the assessed risk of material misstatement to each relevant assertion.

[Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

Entity-Level Controls (Ref: par. .22)

.A35 The auditor's evaluation of entity-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on other controls. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A36 Entity-level controls include

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[19] See paragraph .A113 of SAS No. 145. [Footnote added, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

[20] See paragraph A141 of SAS No. 145. [Footnote added, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

- controls related to the control environment;
- controls over management override;
- the entity's risk assessment process;
- centralized processing and controls, including shared service environments;
- controls to monitor results of operations;
- controls to monitor other controls, including activities of the internal audit function, those charged with governance, and self-assessment programs;
- controls over the period-end financial reporting process; and
- programs and controls that address significant business risks.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A37 Entity-level controls vary in nature and precision:

- Some entity-level controls, such as certain control environment controls, have an important but indirect effect on the likelihood that a misstatement will be prevented, or detected and corrected, on a timely basis. These controls might affect the other controls that the auditor selects for testing and the nature, timing, and extent of procedures the auditor performs on other controls.
- Some entity-level controls monitor the effectiveness of other controls. Such controls might be designed to identify possible breakdowns in lower level controls, but not at a level of precision that would, by themselves, sufficiently address the assessed risk that material misstatements to a relevant assertion will be prevented, or detected and corrected, on a timely basis. These controls, when operating effectively, might allow the auditor to reduce the testing of other controls.
- Some entity-level controls might be designed to operate at a level of precision that would adequately prevent, or detect and correct, on a timely basis misstatements to one or more relevant assertions. If an entity-level control sufficiently addresses the assessed risk of material misstatement, the auditor need not test additional controls relating to that risk.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Smaller, Less Complex Entities

.A38 Controls over management override are important to effective ICFR for all entities and may be particularly important at smaller, less complex entities because of the increased involvement of senior management in performing controls and in the period-end financial reporting process. For smaller, less complex entities, the controls that address the risk of management override might be different from those at a larger entity. For example, a smaller, less complex entity might rely on more detailed oversight by those charged with governance that focuses on the risk of management override. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Evaluating the Components of ICFR (Ref: par. .23)

.A39 ICFR is often described as consisting of five components: control environment, risk assessment, control activities, information and communication, and monitoring. The components are necessary to an effective system of ICFR.[21] This description does not necessarily reflect how an entity designs, implements, and maintains ICFR nor how it may classify any particular component. Auditors may use different terminology or frameworks to describe the various aspects of ICFR and their effect on the audit other than those used in this section, provided that all the components described in this section are addressed. Entities select and develop controls within each component. Controls are interrelated and may support multiple objectives. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A40 The 2013 COSO framework includes principles related to each component that are suitable to all entities. The 2013 COSO framework presumes that all principles are relevant because they have a significant bearing on the presence and functioning of an associated component. There may be a rare industry, operating, or regulatory situation in which management has determined that a principle is not relevant to a component. Considerations in applying this judgment may include the entity structure recognizing any legal, regulatory, industry, or contractual requirements for governance of the entity, and the level of use and dependence on technology used by the entity. The 2013 COSO framework states that management must support its determination that a principle is not relevant with the rationale of how, in the absence of that principle, the associated component can be present and functioning.[22] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A41 When management uses the 2013 COSO framework, the guidance described in paragraphs .A42–.A49 to evaluate the five components is applicable. When management uses the Green Book or another framework, the auditor may adapt the guidance in paragraphs .A42–.A49, as necessary, based on the criteria contained in the framework used by management. For example, when management uses the Green Book, the auditor assesses the relevant principles in the Green Book in lieu of the principles listed in paragraphs .A42–.A49. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Control Environment

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[21]Some material in this section relies upon the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control—Integrated Framework*. The copyright is held by COSO, and the material is used with COSO's permission. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[22]"Suitability and Relevance of Components and Principles" in section 3, "Effective Internal Control" of *Internal Control—Integrated Framework* (COSO, 2013). [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A42 The following principles are relevant to the auditor's evaluation of whether the control environment is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

- The entity demonstrates a commitment to integrity and ethical values.
- Those charged with governance demonstrate independence from management and exercise oversight of the development and performance of ICFR.
- Management establishes, with oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of the entity's financial reporting objectives.
- The entity demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the entity's financial reporting objectives.
- The entity holds individuals accountable for their ICFR responsibilities in the pursuit of the entity's financial reporting objectives.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A43 The evaluation of whether those charged with governance demonstrate independence from management and exercise oversight of the development and performance of ICFR is performed in the context of the entity's governance structure. As described in section 260, *The Auditor's Communication With Those Charged With Governance*, governance structures may vary by entity, reflecting influences such as size and ownership characteristics.[23] For example, in some smaller entities, those charged with governance and management may be the same people. In such smaller entities, the independence of those charged with governance from management may not be necessary to support the achievement of the entity's financial reporting objectives. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A44 The Green Book refers to those charged with governance as the oversight body. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Risk Assessment

.A45 The following principles are relevant to the auditor's evaluation of whether the entity's risk assessment is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

a. The entity specifies financial reporting objectives with sufficient clarity to enable the identification and assessment of risks related to these objectives.

[23]Paragraph .A6 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

b. The entity identifies risks to the achievement of financial reporting objectives across the entity and analyzes risks as a basis for determining how the risks need to be managed.

c. The entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives.

d. The entity identifies and assesses changes that could significantly impact ICFR.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Control Activities Relevant to the Audit of ICFR

.A46 The following principles are relevant to the auditor's evaluation of whether the entity's control activities relevant to the audit of ICFR are present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

a. The entity selects and develops control activities that contribute to the mitigation of risks to the achievement of financial reporting objectives to acceptable levels.

b. The entity selects and develops general control activities over technology to support the achievement of financial reporting objectives.

c. The entity deploys control activities through policies that establish what is expected and procedures that put policies into action.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A47 Control activities relevant to the audit of ICFR include those related to each significant class of transactions, account balance, and disclosure, and its relevant assertions (see paragraphs .26–.28). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Information and Communication

.A48 The following principles are relevant to the auditor's evaluation of whether the entity's information and communication, including the related business processes relevant to financial reporting, is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

a. The entity obtains or generates and uses relevant, quality information to support the functioning of ICFR.

b. The entity internally communicates information, including financial reporting objectives and responsibilities, necessary to support the functioning of ICFR.

c. The entity communicates with external parties regarding matters affecting the functioning of ICFR.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Monitoring Activities

.A49 The following principles are relevant to the auditor's evaluation of whether the entity's monitoring activities are present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:[24]

a. The entity selects, develops, and performs ongoing or separate evaluations to ascertain whether the components of internal control are present and functioning.

b. The entity evaluates and communicates deficiencies in ICFR in a timely manner to those parties responsible for taking corrective action, including senior management and those charged with governance, as appropriate.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Period-End Financial Reporting Process (Ref: par. .24–.25)

.A50 Because the annual period-end financial reporting process normally occurs after the as of date, those controls usually cannot be tested until after the as of date. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions (Ref: par. .26–.28)

.A51 Inherent risk factors are relevant to the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions. Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Inherent risk factors are described in SAS No. 145. [Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.A52 The inherent risk factors that the auditor is required to evaluate in the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions, are the same in the audit of ICFR as in the audit of the financial statements; accordingly, significant classes of transactions, account balances, and disclosures, and their relevant assertions, are the same in an integrated audit. [Paragraph renumbered and amended, effective for integrated audits for periods ending on or after December 15, 2023, by SAS No. 145.]

.A53 The risk assessment procedures performed in connection with a financial statement audit are described in section 315. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A54 The auditor might determine the likely sources of potential misstatements by asking himself or herself "What could go wrong?" within a given significant class of transactions,

[24]Paragraphs .A102–.A107 and appendix B, "Internal Control Components," of section 315. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

account balance, or disclosure. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A55 The components of a potential significant class of transactions, account balance, or disclosure might be subject to significantly different risks. If so, different controls might be necessary to adequately address those risks. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A56 Multiple components are discussed further beginning in paragraphs .78 and .81. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Understanding Likely Sources of Misstatement (Ref: par. .29–.31)

.A57 Performing walk-throughs will frequently be the most effective way of achieving the objectives in paragraph .29. A *walk-through* involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial statements, using the same documents and IT that entity personnel use. Walk-through procedures are inquiry of appropriate personnel, observation of the application of specific controls, inspection of relevant documentation, and control reperformance. The auditor may choose any combination of these procedures; however, inquiry alone is not sufficient for achieving the objectives in paragraph .29. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A58 A walk-through includes questioning the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls at the points at which important processing procedures occur. These probing questions, combined with the other walk-through procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walk-through may provide an understanding of the different types of significant transactions handled by the process. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A59 The identification of risks and controls within IT is not a separate evaluation. Instead, it is an integral part of the top-down approach used to identify likely sources of misstatement and the controls to test, as well as to assess risk and allocate audit effort. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Selecting Controls to Test (Ref: par. .32)

.A60 There might be more than one control that addresses the assessed risk of material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to test all controls related to a relevant assertion nor necessary to test redundant controls, unless redundancy is, itself, a control objective. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A61 The decision concerning whether a control would be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of material misstatement to a given relevant assertion rather than on how the control is labeled (for example, entity-level control, transaction-level control, control activity, monitoring control, preventive control, or detective control). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Testing Controls

Evaluating Design Effectiveness (Ref: par. .33)

.A62 Procedures performed to evaluate design effectiveness may include a mix of inquiry of appropriate personnel, observation of the application of specific controls, and inspection of relevant documentation. Walk-throughs that include these procedures ordinarily are sufficient to evaluate design effectiveness. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Smaller, Less Complex Entities

.A63 A smaller, less complex entity might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex entity might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the entity to implement different controls to achieve its control objectives. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Testing Operating Effectiveness (Ref: par. .34)

.A64 Procedures performed to test operating effectiveness may include a mix of inquiry of appropriate personnel, observation of the application of specific controls, inspection of relevant documentation, and reperformance of the control. Inquiry alone, however, is not sufficient for such purposes. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides additional guidance on other audit procedures, in combination with inquiry, which may be appropriate when testing the operating effectiveness of controls.[25] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A65 In some situations, particularly in smaller, less complex entities, an entity might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for an entity's financial reporting and associated controls, the auditor may take into account the combined competence of entity personnel and other parties that assist with functions related to financial reporting. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Relationship of Risk to the Evidence to Be Obtained (Ref: par. .35–.38)

.A66 For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk

[25] Paragraphs .A28–.A30 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness exists. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A67 Factors that affect the risk associated with a control may include

- the nature and materiality of misstatements that the control is intended to prevent, or detect and correct;
- the inherent risk associated with the related account(s) and assertion(s);
- whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness;
- whether the account has a history of errors;
- the effectiveness of entity-level controls, especially controls that monitor other controls;
- the nature of the control and the frequency with which it operates;
- the degree to which the control relies on the effectiveness of other controls (for example, the control environment or IT general controls);
- the competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance;
- whether the control relies on performance by an individual or is automated (that is, an automated control would generally be expected to be lower risk if relevant IT general controls are effective); and
- the complexity of the control and the significance of the judgments that would be made in connection with its operation.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A68 Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Smaller, Less Complex Entities

.A69 A smaller, less complex entity or component with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas where off-the-shelf software is used, the auditor's testing of IT controls might focus on the application controls built into the prepackaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A70 The auditor's objective is to express an opinion on the entity’s ICFR overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A71 The evidence provided by the auditor's tests of the effectiveness of controls depends upon the mix of the nature, timing, and extent of the auditor's procedures. Further, for an individual control, different combinations of the nature, timing, and extent of testing may provide sufficient appropriate audit evidence in relation to the risk associated with the control. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A72 Walk-throughs might provide sufficient appropriate audit evidence of operating effectiveness, depending on

- the risk associated with the control being tested,
- the frequency of operation of the control,
- whether the control is an IT application control,
- the specific procedures performed as part of the walk-through, and
- the results of those procedures.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A73 The operating effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, informs the auditor’s risk assessments in determining the testing necessary to conclude on the operating effectiveness of a control. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Nature of Tests of Controls

.A74 Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. The following tests that the auditor might perform are presented in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation, and reperformance of a control. Inquiry alone, however, does not provide sufficient appropriate audit evidence to support a conclusion about the effectiveness of a control. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A75 The nature of the tests of effectiveness that will provide sufficient appropriate audit evidence depends, to a large degree, on the nature of the control to be tested, including whether the operation of the control results in documentary evidence of its operation. Documentary evidence of the operation of some controls, such as management's philosophy and operating style, might not exist. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Considerations Specific to Smaller, Less Complex Entities

.A76 A smaller, less complex entity or unit might have less formal documentation regarding the operation of its controls. In those situations, testing controls through inquiry combined with other procedures, such as observation of the application of specific controls, inspection of less formal documentation, or reperformance of certain controls, might provide sufficient appropriate audit evidence about whether the control is effective. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A77 A *control deviation* occurs when a control does not operate as designed. Control deviations are evaluated when determining whether a deficiency in internal control exists. Because effective ICFR cannot and does not provide absolute assurance of achieving the entity's control objectives, an individual control does not necessarily have to operate without any deviation to achieve the entity's control objectives and to be considered effective. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Timing and Extent of Tests of Controls (Ref: par. .39)

.A78 The objective of the tests of controls in an audit of ICFR is to obtain evidence about the effectiveness of controls to support the auditor's opinion on the entity's ICFR. The auditor's opinion relates to the effectiveness of the entity's ICFR as of a point in time and as a whole. Accordingly, an audit of ICFR may entail testing the design and operating effectiveness of controls not tested when expressing an opinion only on the financial statements; however, in both an audit of ICFR and a financial statement audit, the auditor directs attention to controls that present a reasonable possibility that, if missing or deficient, would result in a material misstatement of the financial statements. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A79 Testing controls over a longer period of time provides more evidence of the effectiveness of controls than testing over a shorter period of time. Further, testing performed closer to the as of date provides more evidence than testing performed earlier in the year. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A80 The more extensively a control is tested, the greater the evidence obtained from that test. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A81 Prior to the as of date, management might implement changes to the entity's controls to make them more effective or efficient or to address deficiencies. If the auditor determines that the new controls achieve the related objectives of the criteria and have been in effect for a sufficient period to permit the auditor to assess their design and operating effectiveness by performing tests of controls, the auditor will not need to test the design and operating effectiveness of the superseded controls for purposes of expressing an opinion on ICFR. If the operating effectiveness of the superseded controls is important to the auditor's control risk assessment in the financial statement audit, the auditor tests the design and operating effectiveness of those superseded controls, as appropriate. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Rollforward Procedures (Ref: par. .40)

.A82 The additional evidence that is necessary to update the results of testing from an interim date to the entity's period-end depends on the following factors:

- The specific control tested prior to the as of date, including the risks associated with the control, the nature of the control, and the results of those tests
- The sufficiency of the evidence of operating effectiveness obtained at an interim date
- The length of the remaining period
- The possibility that there have been any significant changes in ICFR subsequent to the interim date

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A83 In some circumstances, such as when evaluation of these factors indicates a low risk that the controls are no longer effective during the rollforward period, inquiry alone might be sufficient as a rollforward procedure. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Special Considerations for Subsequent Years' Audits (Ref: par. .41–.42)

.A84 Factors that affect the risk associated with a control in subsequent years' audits include those in paragraph .A67 and the following:

- The nature, timing, and extent of procedures performed in previous audits
- The results of the previous years' testing of the control
- Whether there have been changes in the control or the process in which it operates since the previous audit

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A85 After taking into account the risk factors identified in paragraphs .A67 and .A84, the additional information available in subsequent years' audits might permit the auditor to assess the risk as lower than in the initial year. This, in turn, might permit the auditor to reduce testing in subsequent years. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A86 The auditor also may use a benchmarking strategy for automated application controls in subsequent years' audits. Benchmarking is described further beginning in paragraph .97. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A87 The auditor might test controls at a different interim period, increase or reduce the number and types of tests performed, or change the combination of procedures used. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Identifying Deficiencies in ICFR (Ref: par. .43)

.A88 The findings from audit work performed on the financial statements and on ICFR are relevant in determining whether the auditor has identified any deficiencies in ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Determination of Whether Material Weaknesses Exist as of the Date Specified in Management's Assessment About ICFR (Ref: par. .44–.46)

.A89 The severity of a deficiency, or a combination of deficiencies, in ICFR depends 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 a class of transaction, an account balance, or a disclosure.

A material weakness may exist even though the auditor has not identified misstatements during the integrated audit. Paragraph .A97 provides indicators of material weaknesses. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A90 Factors that affect the magnitude of a misstatement that might result from a deficiency, or deficiencies, in ICFR include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected in future periods) in the account or class of transactions exposed to the deficiency

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A91 In evaluating the magnitude of the potential misstatement, the maximum amount by which an account balance or total of transactions can be overstated is generally the recorded amount, whereas understatements could be larger. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A92 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in ICFR will result in a misstatement of an account balance or a disclosure. The factors include the following:

- The nature of the financial statement, classes of transactions, account balances, disclosures, and assertions involved
- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in ICFR
- The susceptibility of the related asset or liability to loss or fraud

- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in ICFR
- The possible future consequences of the deficiency, or deficiencies, in ICFR
- The importance of controls, such as the following, to the financial reporting process:
  - — General monitoring controls (such as oversight of management)
  - — Controls over the prevention and detection of fraud
  - — Controls over the selection and application of significant accounting policies
  - — Controls over significant transactions with related parties
  - — Controls over significant unusual transactions
  - — Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[As amended, effective for integrated audits for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A93 The evaluation of whether a deficiency in ICFR presents a reasonable possibility of misstatement may be made without quantifying the probability of occurrence as a specific percentage or range. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A94 Controls may be designed to operate individually, or in combination, to effectively prevent, or detect and correct, misstatements. For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A95 A deficiency in ICFR on its own may not be sufficiently important to constitute a material weakness. However, a combination of deficiencies affecting the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR may increase the risks of misstatement to such an extent to give rise to a material weakness. A combination of deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR also may collectively result in a significant deficiency. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A96 A compensating control can limit the severity of a deficiency in ICFR and prevent it from being a material weakness. Only compensating controls that operate at a level of precision that would prevent, or detect and correct, a material misstatement are capable of having a mitigating effect. Although compensating controls can mitigate the effects of a deficiency in ICFR, they do not eliminate the deficiency. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A97 Indicators of material weaknesses in ICFR include

- identification of fraud, whether or not material, on the part of senior management. For the purpose of this indicator, the term *senior management* includes the principal executive and financial officers as well as any other members of senior management who play a significant role in the entity's financial reporting process;
- restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error;
- identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's ICFR; and
- ineffective oversight of the entity's financial reporting and ICFR by those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Determination of Whether Significant Deficiencies Exist During the Integrated Audit (Ref: par. .47)

.A98 Paragraphs .A89–.A96 provide guidance related to evaluating the severity of identified deficiencies in ICFR. Paragraph .A97 provides indicators of material weaknesses. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A99 The evaluation of the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a significant deficiency is made for purposes of communicating in writing to management and those charged with governance significant deficiencies identified during the integrated audit. See paragraphs .59–.63 for the communication requirements. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Subsequent Events (Ref: par. .48–.51)

.A100 Section 560, *Subsequent Events and Subsequently Discovered Facts*, establishes requirements and provides guidance on subsequent events for a financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. The auditor is required by paragraph .57 to obtain certain written representations from management relating to subsequent events. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A101 Refer to paragraph .80 when disclaiming an opinion on management's disclosures about corrective actions. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A102 The evaluation of such subsequently discovered facts is similar to the evaluation of subsequently discovered facts in an audit of financial statements, as described in section 560. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Concluding Procedures (Ref: par. .52–.56)

.A103 If management does not revise its report, paragraph .72 applies. Paragraph .71 also applies if the auditor determines that management's required disclosure about one or more material weaknesses is not fairly presented in all material respects. If management refuses to furnish a report that includes management's assessment about ICFR, paragraph .74 applies. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Obtaining Written Representations (Ref: par. .57–.58)

.A104 See section 580, *Written Representations*, for additional requirements and guidance with respect to obtaining written representations from management as part of an audit of financial statements. Section 580 addresses matters such as who should sign the letter, the period to be covered by the letter, and when to obtain an updated letter. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A105 Management's refusal to furnish written representations constitutes a limitation on the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Communicating ICFR-Related Matters (Ref: par. .59–.63)

.A106 Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, does not apply to integrated audits. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A107 Early communication to management or those charged with governance may be important for some matters because of their relative significance and the urgency of corrective follow-up action. Regardless of the timing of the written communication of significant deficiencies and material weaknesses, the auditor may communicate these orally in the first instance to management and, when appropriate, those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. However, oral communication does not relieve the auditor of the responsibility to communicate the significant deficiencies and material weaknesses in writing. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A108 If a previously communicated significant deficiency or material weakness remains, the current year's communication may repeat the description from the previous communication or simply reference the previous communication and the date of that communication. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A109 See section 230, *Audit Documentation*, for additional guidance related to the report release date.[26] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A110 The auditor's written communication for a governmental entity would generally not be made prior to management's report on ICFR, the entity's financial statements, and the auditor's report thereon, being made publicly available. This is in order to provide the user with the appropriate context to evaluate the significant deficiencies or material weaknesses identified during the integrated audit that are contained in the written communication. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A111 The auditor is not required to perform procedures that are sufficient to identify all deficiencies; rather, the auditor need only communicate deficiencies of which the auditor is aware. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A112 Unlike in an audit of financial statements that is not integrated with an audit of ICFR, the auditor is required to communicate in writing deficiencies that do not rise to the level of significant deficiencies or material weaknesses. This is because identifying deficiencies in ICFR is the focus of an audit of ICFR, whereas identifying deficiencies is incidental to an audit of financial statements (that is not integrated with an audit of ICFR), which is focused on identifying misstatements of the financial statements. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A113 Because the auditor's written communication of deficiencies identified during the integrated audit forms part of the final audit file, the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis, no later than 60 days following the report release date.[27] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Reporting on ICFR (Ref: par. .64–.65)

Considerations Specific to Governmental Entities

.A114 When the audit is also conducted in accordance with *Government Auditing Standards* (also known as the Yellow Book), the auditor may state that the audit was conducted in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. If significant deficiencies in ICFR are identified in such an audit and the auditor's report refers to *Government Auditing Standards*, those standards require the auditor to report such deficiencies as findings. The following is an illustration of that communication through the addition of other-matter paragraphs to the auditor's report:

[26]Paragraph .A2 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[27]Paragraph .16 of section 230. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies in ABC Company's internal control described below [*or in the accompanying schedule of findings*] to be significant deficiencies.

Government Auditing Standards require the auditor to perform limited procedures on ABC Company's response, described below [*or in the accompanying schedule of findings*], to the findings identified in our audit of internal control over financial reporting. ABC Company's response was not subjected to the other auditing procedures applied in the audit of internal control over financial reporting and, accordingly, we express no opinion on the response.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

[.A115] [Paragraph deleted by the issuance of SAS No. 140, April 2020. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A116 The auditor may choose to issue a combined report (that is, one report containing both an opinion on the financial statements and an opinion on ICFR) or separate reports on the entity's financial statements and on ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A117 If the auditor issues a separate report on ICFR and expresses an adverse opinion on ICFR, the disclosure required by paragraph .69 related to the effect of the adverse opinion on ICFR on the auditor's opinion on the financial statements may be combined with the report language described in paragraph .65. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A118 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.[28] When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.[29] [Paragraph added, effective for audits of financial statements for

[28]See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[29]Paragraph .21 of section 220A. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

periods ending on or after December 15, 2021, by SAS No. 140. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Report Modifications (Ref: par. .67)

.A119 A *limitation on the scope of the audit* refers to the auditor's inability to obtain sufficient appropriate audit evidence, which may arise from the following:

- Circumstances beyond the entity's control
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management

[Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Adverse Opinions (Ref: par. .68–.71)

.A120 Paragraphs .44–.47 describe the evaluation of deficiencies. See paragraphs .73–.77 when the scope of the engagement has been limited. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A121 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, establishes requirements and provides guidance on adverse opinions for a financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A, "Illustrative Reports," of this section includes an illustration of the application of the reporting requirements in section 705.[30] [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A122 As described in paragraph .A116, if the auditor issues a separate report on ICFR in this circumstance, the disclosure required by paragraph .69 may be combined with the report language described in paragraph .65. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A123 The auditor's report need only refer to the "material weaknesses described in management's report" and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report, as described in paragraph .71. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[30] Illustration 2, "Adverse Opinion on ICFR," of exhibit A, "Illustrative Reports." [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Scope Limitations (Ref: par. .73–.77)

.A124 The auditor may be separately engaged to audit only the financial statements after withdrawing from the integrated audit. In such circumstances, the auditor cannot disregard knowledge obtained in the integrated audit engagement in determining whether to accept, or in performing, the financial statement audit. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A125 Section 705 establishes requirements and provides guidance on disclaimers of opinion for a financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in section 705.[31] [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A126 In an audit of ICFR, the auditor is not required to perform any additional work prior to issuing a disclaimer when the auditor concludes that the auditor will not be able to obtain sufficient appropriate audit evidence to express an opinion. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A127 The auditor's report need only refer to the "material weaknesses described in management's report" and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Making Reference to a Component Auditor and Assuming Responsibility for the Work of a Component Auditor (Ref: par. .78–.79)

.A128 Section 600A addresses special considerations that apply to group audits, in particular those that involve component auditors. Section 600A is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to multiple components discussed beginning in paragraphs .28 and .81. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A129 The group engagement partner may decide to assume responsibility for the work of the component auditor or to make reference to the component auditor in the report on the ICFR over the group financial statements. The decision about whether to make reference to a component auditor in the report on the audit of ICFR might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the group financial statements may make reference to the audit of a significant equity investment performed by a component auditor, but the report on the ICFR over the group

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[31] Illustration 3, "Disclaimer of Opinion on ICFR," of exhibit A. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

financial statements might not make a similar reference because management's assessment about ICFR ordinarily would not extend to controls at the equity method investee. See paragraph .84 for further discussion of the evaluation of the controls for an equity method investment. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A130 Section 600A establishes requirements and provides guidance when assuming responsibility for the work of a component auditor and when making reference to a component auditor in the auditor's report on the financial statements that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in section 600A.[32] [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Additional Information (Ref: par. .80)

.A131 The additional information as discussed in paragraph .80 typically relates to circumstances in which management includes a description of a response to an identified material weakness, including plans to remediate but is not limited to those matters. The following is an example of wording used to disclaim an opinion on such additional information.[33]

> **Other Matter**
>
> We did not perform auditing procedures on [*describe additional information, such as management's cost-benefit statement*], and accordingly, we do not express an opinion or provide any assurance on it.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A132 An entity may publish various documents that contain information in addition to management's report and the auditor's report on ICFR. Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, as well as section 720, may require the auditor to take additional action. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[32] Illustration 4, "Unmodified Opinion on ICFR Making Reference to a Component Auditor," of exhibit A. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[33] The requirements in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, would also apply if the information and related auditor's reports are included in an entity's annual report. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Special Topics

Entities With Multiple Components (Ref: par. .81–.83)

.A133 As indicated in paragraph .A128 of this section, section 600A is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to components discussed in this section. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A134 In determining the components at which to perform tests of controls, the group engagement team may also take into account work performed by the internal audit function or others on behalf of management. For example, if the internal audit function's planned procedures include relevant audit work at various components, the auditor may coordinate work with the internal auditors and reduce the number of components at which the group engagement team, or a component auditor on the group engagement team's behalf, would otherwise need to perform audit procedures. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A135 The group engagement team may eliminate from further consideration components that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the group financial statements. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A136 In lower risk components, the group engagement team first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides sufficient appropriate audit evidence. The group engagement team or a component auditor on the group engagement team's behalf may test the operating effectiveness of controls over specific risks or group-wide controls. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Special Situations (Ref: par. .84–.87)

.A137 The audit of ICFR ordinarily would not extend to controls at the equity method investee. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

.A138 The auditor may conclude it is appropriate for management to limit the assessment by excluding certain entities when, for example, management has insufficient time to assess the controls at the as of date for a recently acquired business or does not have sufficient access to a consolidated variable interest entity. However, in the case of an acquired entity, it would not be appropriate for management to limit its assessment if the period of such limitation extends beyond one year from the date of acquisition, nor would it be appropriate for management's assessment to be limited for more than one annual management report on ICFR. Law or regulation may specifically address situations in which it is appropriate for management to limit its assessment by excluding certain entities and also may require specific disclosures in these cases. If, in the auditor's judgment, it is appropriate for management to limit its assessment by excluding certain entities, the auditor may limit the audit of ICFR in the same manner, and the auditor's opinion would not be affected by a scope limitation. [Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Use of Service Organizations (Ref: par. .88–.96)

.A139 Section 402 contains the requirements and application guidance for auditors of the financial statements of entities that use a service organization (user auditors). Section 402 addresses an auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of an entity that uses one or more service organizations (a user entity). Refer to section 402 for guidance when the service organization uses a subservice organization.[34] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A140 Section 402 identifies the situations in which a service organization's services and controls over them are part of a user entity's information system.[35] If the service organization's services are part of the user entity's information system, as described therein, then they are part of the user entity's ICFR. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A141 Evidence that the controls that are relevant to the auditor's opinion on ICFR are operating effectively may be obtained by following the procedures described in section 402.[36] These procedures include one or more of the following:

a. Obtaining and reading a service auditor's report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls, which includes a description of the service auditor's tests of controls and results (a type 2 report), if available

b. Performing appropriate tests of controls at the service organization

c. Using another auditor to perform tests of controls at the service organization on behalf of the auditor

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A142 A report on management's description of a service organization's system and the suitability of the design of controls (a type 1 report) does not include a description of the service auditor's tests of controls and results of those tests or the service auditor's opinion

[34] Paragraph .A20 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[35] Paragraph .03 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[36] Paragraphs .16–.17 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

on the operating effectiveness of controls and, therefore, does not provide evidence of the operating effectiveness of controls. Type 1 and type 2 reports are described in section 402. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A143 These factors are similar to factors the auditor would consider in determining whether the report provides sufficient appropriate audit evidence to support the auditor's assessed level of control risk in an audit of the financial statements, as described in section 402.[37] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A144 Section 402 defines *complementary user entity controls* as those controls that management of the service organization assumes, in the design of its service, will be implemented by user entities, and, if necessary to achieve the control objectives stated in management's description of the service organization's system, are identified as such in that description. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A145 Appropriate sources of information concerning the service auditor's professional competence and independence are discussed in section 402.[38] [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A146 Standards promulgated by a body designated by Council, pursuant to the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, are presumed to be adequate. Although the International Auditing and Assurance Standards Board (IAASB) is not such a body, AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, may be helpful when the service auditor's report is issued in accordance with International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, promulgated by the IAASB.[39] [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A147 Changes in the service organization's controls may include

- changes communicated to management from the service organization, including those related to the service organization's processes and information systems.
- changes in personnel at the service organization with whom management interacts.
- changes in the design or implementation of controls that were necessary to achieve the control objectives.
- changes in reports or other data received from the service organization.

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[37]Paragraphs .A32–.A39 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[38]Paragraphs .A21–.A22 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

[39][Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020. Footnote subsequently renumbered by the issuance of SAS No. 145, October 2021.]

- changes in contracts or service level agreements with the service organization.
- errors identified in the service organization's processing or incidents of noncompliance with laws and regulations or fraud.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A148 As risk increases, the need for the auditor to obtain additional evidence increases. If the auditor concludes that additional evidence about the operating effectiveness of controls at the service organization is required, the auditor's additional procedures might include

- evaluating procedures performed by management and the results of those procedures.
- contacting the service organization, through the user entity, to obtain specific information.
- requesting that a service auditor be engaged to perform procedures that will supply the necessary information.
- visiting the service organization and performing such procedures.

[Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Benchmarking of Automated Controls (Ref: par. .97–.99)

.A149 Entirely automated application controls are generally less susceptible to breakdowns due to human failure. This feature may allow the auditor to use a benchmarking strategy. *Benchmarking* is the process of testing an automated application control to establish a baseline that can be combined with effective IT general controls to allow the auditor to conclude that the automated application controls are effective without repeating the specific tests of operating effectiveness. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A150 When the risk factors assessed in determining a benchmarking strategy indicate lower risk, the control being evaluated might be well-suited for benchmarking. When these factors indicate increased risk, the control being evaluated is less suited for benchmarking. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A151 A report of the compilation dates of the programs placed in operation may be used as evidence that controls within the program have not changed. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A152 Benchmarking automated application controls can be especially effective for entities using purchased software when the possibility of program changes is remote (for example, when the vendor does not allow access or modification to the source code). [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A153 If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor determines that the automated application control has not changed since the auditor established a baseline (that is, last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor obtains to determine that the control has not changed may vary depending on the circumstances, including the strength of the entity's program change controls. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A154 The consistent and effective functioning of the automated application controls may be dependent upon the related files, tables, data, and parameters. For example, an automated application for calculating interest income might be dependent on the continued integrity of a rate table used by the automated calculation. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

.A155 A control may be sensitive to other business factors that may have changed. For example, an automated control may have been designed with the assumption that only positive amounts will exist in a file. Such a control would no longer be effective if negative amounts (credits) begin to be posted to the account. [Paragraph renumbered by the issuance of SAS No. 145, October 2021.]

Exhibit A — Illustrative Reports

.A156 The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR

Illustration 2 — Adverse Opinion on ICFR

Illustration 3 — Disclaimer of Opinion on ICFR

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

Illustration 1 — Unmodified Opinion on ICFR

The following is an illustrative report expressing an unmodified opinion on ICFR.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on Internal Control Over Financial Reporting[1]

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 21, 20XX, based on [*identify criteria*].

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [*identify financial statements*] of ABC Company, and our report dated [*date of report, which should be the same as the date of the report on the audit of ICFR*] expressed [*include nature of opinion*].

Basis for Opinion

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*].

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable

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[1]The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that 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. Also, projections of any assessment of effectiveness to future periods are 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.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities*.]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — Adverse Opinion on ICFR

The following is an illustrative report expressing an adverse opinion on ICFR. In this example, the opinion on the financial statements is not affected by the adverse opinion on ICFR.

<u>**Independent Auditor's Report**</u>

[*Appropriate Addressee*]

Report on Internal Control Over Financial Reporting[1]

Adverse Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] In our opinion, because of the effect of the material weakness described in the Basis for Adverse Opinion section on the achievement of the objectives of [*identify criteria*], ABC Company has not maintained effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [*identify financial statements*] of ABC Company, and our report dated [*date of report, which should be the same as the date of the report on the audit of ICFR*] expressed [*include nature of opinion*].

We considered the material weakness described in the Basis for Adverse Opinion on Internal Control Over Financial Reporting section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements

Basis for Adverse Opinion on Internal Control Over Financial Reporting

A material weakness is a deficiency, or a 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. The following material weakness has been identified and included in the accompanying [*title of management's report*].

[*Identify the material weakness described in management's report.*][3]

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[1]The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

[3]See paragraphs .68–.71 of this section for specific reporting requirements. The auditor's report need only refer to the material weaknesses described in management's report and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report.

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*].

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that 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. Also, projections of any assessment of effectiveness to future periods are 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.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 3 — Disclaimer of Opinion on ICFR

The following is an illustrative report expressing a disclaimer of opinion on ICFR. In this example, the auditor is applying paragraph .76 of this section because a material weakness was identified during the limited procedures performed by the auditor.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on Internal Control Over Financial Reporting[1]

Disclaimer of Opinion on Internal Control Over Financial Reporting

We were engaged to audit ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] Because of the significance of the matter described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the effectiveness of ABC Company's internal control over financial reporting.

We have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [*identify financial statements*] of ABC Company, and our report dated [*date of report, which should be the same as the date of the report on the audit of ICFR*] expressed [*include nature of opinion*].

We considered the material weakness described in the [*include section title of where the material weakness information is included in the report*][3] section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.

Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting

[*Provide description of the matter giving rise to the disclaimer of opinion*]

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [*title of management's report*].

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[1]The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

[3]In this illustration, the material weakness information is included in a separate section with the title "Material Weakness." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021.]

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our responsibility is to conduct an audit of ABC Company's internal control over financial reporting in accordance with GAAS. However, because of the matter described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that 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. Also, projections of any assessment of effectiveness to future periods are 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.

Material Weakness[4]

A material weakness is a deficiency, or a 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. If one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective. The following material weakness has been included in the accompanying [*title of management's report*].

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[4]Paragraph .76 does not specify the placement of this information. The sample in the illustrative auditor's report includes the information in a separate section with the title "Material Weakness;" however, auditors have discretion to present this information in the part of the report they consider appropriate. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021.]

[*Identify the material weakness described in management's report and include a description of the material weakness, including its nature and actual and potential effect on the presentation of the entity's financial statements issued during the existence of the material weakness.*]

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the report of a component auditor.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on Internal Control Over Financial Reporting[1]

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] In our opinion, based on our audit and the report of the other auditors, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].

We did not audit the effectiveness of internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 20 percent and 30 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 20XX. The effectiveness of B Company's internal control over financial reporting was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the effectiveness of B Company's internal control over financial reporting, is based solely on the report of the other auditors.

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [*identify financial statements*] of ABC Company, and our report dated [*date of report, which should be the same as the date of the report on the audit of ICFR*] expressed [*include nature of opinion*], based on our audit and the report of the other auditors.

Basis for Opinion

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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[1]The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

Responsibilities of Management for the Audit of Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [*title of management's report*].

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that 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. Also, projections of any assessment of effectiveness to future periods are 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.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

The following is an illustrative combined report expressing an unmodified opinion on ICFR and an unmodified opinion on the financial statements. The circumstances include the following:

- An audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements and Internal Control[1]

Opinions on the Financial Statements and Internal Control Over Financial Reporting

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] In our opinion, ABC Company maintained,

[1]The subtitle "Report on the Financial Statements and Internal Control" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*].

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting

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

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of financial statements or an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered to be material if there is a

[2]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audits
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the statement audit in order to design audit procedures that are appropriate in the circumstances.
- Obtain an understanding of internal control over financial reporting relevant to the audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that 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. Also, projections of any assessment of effectiveness to future periods are 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.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Exhibit B — Illustrative Written Communication of Significant Deficiencies and Material Weaknesses

.A157 The following is an illustrative written communication of significant deficiencies and material weaknesses.

To Management and [*identify the body or individuals charged with governance, such as the entity's board of directors*] of ABC Company:

In connection with our audit of ABC Company's (the Company) financial statements as of December 31, 20XX, and for the year then ended, and our audit of the Company's internal control over financial reporting as of December 31, 20XX (integrated audit), auditing standards generally accepted in the United States of America require that we advise you of the following matters relating to internal control over financial reporting (internal control) identified during our integrated audit.

Our responsibility is to plan and perform our integrated audit to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error, and whether effective internal control was maintained in all material respects (that is, whether material weaknesses exist as of the date specified in management's assessment). The integrated audit is not designed to detect deficiencies that, individually or in combination, are less severe than a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, 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. [*We consider the following deficiencies in the Company's internal control to be material weaknesses:*

[*Describe the material weaknesses that were identified during the integrated audit and provide an explanation of their potential effects. The auditor may separately identify those material weaknesses that exist as of the date specified in management's assessment about ICFR by referring to the auditor's report.*]

[*A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Company's internal control over financial reporting to be significant deficiencies:*]

[*Describe the significant deficiencies that were identified during the integrated audit and provide an explanation of their potential effects.*]

This communication is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, and [*identify any governmental authorities to which the auditor is required to report*] and is not intended to be and should not be used by anyone other than these specified parties.[1]

[*Auditor's signature*]

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[1]When the engagement is also performed in accordance with *Government Auditing Standards*, see paragraph .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, for alternative reporting requirements.

[*Auditor's city and state*]

[*Date*]

[Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Exhibit C — Illustrative Management Report

.A158 The following is an illustrative management report containing the reporting elements described in paragraph .55 of this section with no material weaknesses reported.

Management's Report on Internal Control Over Financial Reporting

ABC Company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management of ABC Company is responsible for designing, implementing, and maintaining effective internal control over financial reporting. Management assessed the effectiveness of ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[1] Based on that assessment, management concluded that, as of December 31, 20XX, ABC Company's internal control over financial reporting is effective, based on [*identify criteria*].

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are 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.

ABC Company

Report signers, if applicable

Date

[1]For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

[Paragraph renumbered by the issuance of SAS No. 140, April 2020. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

Exhibit D — Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act

.A159

1. The Federal Deposit Insurance Corporation (FDIC) has provided guidance on the meaning of the term *financial reporting* for purposes of compliance by insured depository institutions (IDIs) with Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36 of the Federal Deposit Insurance Act [FDI Act], 12.U.S.C. 1831m), and its implementing regulation, 12 CFR Part 363. The FDIC's guidance indicates that financial reporting, at a minimum, includes both financial statements prepared in accordance with generally accepted accounting principles (GAAP) for the IDI (or its holding company) and financial statements prepared for regulatory reporting purposes. Financial statements prepared for regulatory reporting purposes include the schedules equivalent to the GAAP-based financial statements that are included in an IDI's (or its holding company's) appropriate regulatory report (for example, Schedules RC, RI, and RI-A in the Consolidated Reports of Condition and Income [Call Report]). Accordingly, to comply with the FDICIA and Part 363, management of the IDI (or its holding company) and the auditor are required to identify and test controls over the preparation of GAAP-based financial statements as well as the schedules equivalent to the GAAP-based financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report. Further, both management and the auditor are required to include in their report on the IDI's (or its holding company's) internal control over financial reporting (ICFR) a specific description indicating that the scope of ICFR included controls over the preparation of the IDI's (or its holding company's) GAAP-based financial statements as well as the schedules equivalent to the GAAP-based financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report.[1]

Definition of ICFR for FDICIA Purposes

2. In accordance with paragraph .64*g* of this section, the auditor's report is required to include a definition of ICFR that uses the same description of ICFR that management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is an insured bank (which is not subject to Section 404 of the Sarbanes-Oxley Act of 2002) elects to report on controls for FDICIA purposes at the bank holding company level:

> An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [*Holding Company's*] internal control over financial reporting

[1] Refer to Section 36 of the Federal Deposit Insurance Act (FDI Act), Section 363.1: Scope and Definitions, for the requirements pertaining to compliance by subsidiaries of holding companies.

included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C).[2] An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Requirements When the IDI Is Required to Report on ICFR at the IDI Level

3. This paragraph and the following paragraphs are applicable and provide guidance when an IDI is required by 12 CFR Part 363 to report on ICFR at the IDI level. An IDI that is a subsidiary of a holding company may use the consolidated holding company's financial statements (group financial statements) to satisfy the audited financial statements requirement of 12 CFR Part 363, provided certain criteria are met.[3] For some IDIs, however, an audit of ICFR is required at the IDI level. An audit of ICFR is required to be integrated with an audit of financial statements. Accordingly, to comply with the integrated audit requirements in this section, when the IDI elects to use the holding company's group financial statements to satisfy the audited financial statements requirement of 12 CFR Part 363 and the audit of ICFR is required to be performed at the IDI level, the auditor would be required to perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion on the IDI's financial statements and on its ICFR. When the IDI does not prepare financial statements at the IDI level for external distribution, "financial statements" for this purpose may consist of the IDI's financial information in a reporting package or equivalent schedules and analyses that include the IDI information necessary for the preparation of the holding company's group financial statements, including disclosures. The measurement of materiality is determined based on the IDI's financial information rather than the holding company's group financial statements.[4] If the auditor is unable to apply the procedures necessary to obtain sufficient appropriate audit evidence with respect to the IDI's financial information, the auditor is required by paragraph .73 of this section to withdraw from the engagement or disclaim an opinion on the effectiveness of ICFR at the IDI level.

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[2]This sentence would be modified if the insured depository institution (IDI) reports at the institution level rather than at the bank holding company level to refer to the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income instead of to the Form FR Y-9C. This sentence would also be modified if the IDI reports at a holding company level and employs another approach to reporting on controls over the preparation of regulatory reports as permitted by Section 36 of the FDI Act.

[3]See footnote 1.

[4]See paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

Evaluation of IDI Financial Reporting Process

4. As previously described, the FDIC indicated that financial reporting, at a minimum, includes both financial statements prepared in accordance with generally accepted accounting principles (GAAP) for the IDI (or its holding company) and financial statements prepared for regulatory purposes. Financial statements prepared for regulatory reporting purposes include the schedules equivalent to the GAAP-based financial statements that are included in an IDI's (or its holding company's) appropriate regulatory report. When the IDI does not prepare financial statements for external distribution, the auditor is, nevertheless, required by paragraph .24 of this section to evaluate the IDI's period-end financial reporting process. This process includes, among other things, the IDI's procedures for preparing financial information for purposes of the holding company's group financial statements, which are prepared in accordance with GAAP, and the schedules equivalent to the GAAP-based financial statements that are included in the IDI's appropriate regulatory report.

Organization Structure

5. The period-end financial reporting process may occur either at the IDI or the holding company, or both. The organizational structure, including where the controls relevant to the IDI's financial information operate, may affect how the auditor evaluates this process. For example

a. when the period-end financial reporting process occurs at the holding company and the IDI comprises substantially all of the consolidated total assets, there may be no distinguishable difference between the IDI's and its holding company's process for purposes of the integrated audit. This is because the auditor's risk assessment, including the determination of significant classes of transactions, account balances, and disclosures, and their relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control, would likely be the same for the IDI and the holding company.[5] In this circumstance, the period-end financial reporting process of the holding company would be, in effect, the period-end financial reporting process of the IDI and, therefore, would be included in the scope of the integrated audit of the IDI.

b. when the period-end financial reporting process occurs at the holding company and the IDI does not comprise substantially all of the consolidated total assets, the IDI's financial reporting process may be sufficient for the auditor to meet the requirement in paragraph .24 of this section, if the necessary GAAP information is prepared by the IDI or the holding company, and the process can be evaluated by the auditor. The auditor may determine that the IDI's preparation of the IDI's appropriate regulatory report, together with other financial information at the IDI level that is incorporated into the holding company's group financial statements, is sufficient for this purpose. In this circumstance, both the period-end financial reporting process of the holding company, as it relates to the financial information of the IDI, and the period-end financial reporting process of the IDI, with respect to the preparation of

[5] See paragraph .A23 of this section.

the schedules equivalent to the basic financial statements that are included in the IDI's appropriate regulatory report, would be included in the scope of the integrated audit of the IDI.

IDI Not Subject to Section 404 of Sarbanes-Oxley Act of 2002

6. The illustrative reports in exhibit A, "Illustrative Reports," of this section may be used to report on the effectiveness of the IDI's ICFR. Because 12 CFR Part 363 does not require the auditor to issue a separate auditor's report on the IDI's financial statements, the requirement in paragraph .65 of this section to add a paragraph to the ICFR report that references the financial statement audit will not apply when the auditor does not issue a separate auditor's report on the IDI's financial statements. In accordance with paragraph .64 of this section, the auditor's report on ICFR is required to include a definition of ICFR that uses the same description of ICFR as management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is not subject to Section 404 of the Sarbanes-Oxley Act of 2002 is required to report on controls for FDICIA purposes at the IDI level, and the IDI uses the holding company's group financial statements to satisfy the audited financial statements requirement of 12 CFR Part 363:

> An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [*IDI's*] internal control over financial reporting included controls over the preparation of financial information for purposes of [*consolidated holding company's*] financial statements in accordance with accounting principles generally accepted in the United States of America and controls over the preparation of schedules equivalent to basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (Call Report Instructions). An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Use of the *Internal Control — Integrated Framework* (2013) (COSO)

7. Management may evaluate and report on the effectiveness of the IDI's ICFR based on the report *Internal Control—Integrated Framework* (2013), issued by Committee of Sponsoring Organizations of the Treadway Commission's (COSO). For purposes of reporting under Section 112 of FDICIA, the COSO criteria relevant to internal reporting objectives are appropriate only for the IDI and its regulatory agencies that are presumed to have an adequate understanding of the level of the auditor's service on historical financial information, considering the IDI does not prepare external GAAP-based financial statements. Accordingly, the report is required to include an other-matter paragraph, under an appropriate heading, that restricts its use.[6] An example of such a restriction is as follows:

> ***Restriction on Use***[7]
>
> This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, the Federal Deposit Insurance Corporation and [*other federal bank regulatory agency*] and is not intended to be and should not be used by anyone other than these specified parties.

8. Likewise, the auditor's report and management's assessment about ICFR refer to the COSO criteria relevant to internal reporting objectives. For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to internal reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA)."

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140. Paragraph subsequently renumbered by the issuance of SAS No. 145, October 2021.]

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[6]See paragraphs .06*a* and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. Although reports on internal control issued in accordance with the guidance in this appendix are required to be restricted as to use, Section 36 of the FDI Act and Title 12 U.S. *Code of Federal Regulations* Part 363 require that these reports be available for public inspection.

[7]Another appropriate heading may be used.

AU-C Section 945

Auditor Involvement With Exempt Offering Documents

Source: SAS No. 133; SAS No. 137.

Effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when both of the following conditions exist:

a. The auditor's report on financial statements or the auditor's review report on interim financial information of an entity is included or incorporated by reference in an offering document relating to either of the following:

    i. Securities, when either the transaction or the securities themselves are exempt from registration under the Securities Act of 1933, as amended (Securities Act of 1933)

    ii. Franchise offerings regulated by the Federal Trade Commission (FTC) or applicable state franchise laws

    Hereafter, such security and franchise offerings are referred to as "exempt offerings" for purposes of this section.

b. The auditor performs one or more of the activities in paragraph .08*b* with respect to the exempt offering document.

In such situations, the auditor is deemed to be involved with the exempt offering document. (Ref: par. .A1–.A3)

.02 Exempt offerings are made pursuant to federal or state securities laws and regulations or pursuant to federal or state franchise laws and regulations, including, in each case, the antifraud provisions thereof.[1] Exempt offerings include, but are not limited to, the following:

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[1]Exhibit A, "Examples of Exempt Offerings," provides examples of types of offerings within the scope of this section.

- Securities transactions that are exempt from the registration requirements of Section 5 of the Securities Act of 1933, such as private placement offerings, exempt public offerings, and municipal securities offerings
- Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the Securities Act of 1933
- Franchise offerings

Effective Date

.03 This section is effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018. (Ref: par. .A4)

Objectives

.04 The objectives of the auditor when involved with an exempt offering document are to perform procedures specified in this section and respond appropriately as follows:

a. When the auditor determines that information included or incorporated by reference in the exempt offering document could undermine the credibility of the financial statements and the auditor's report thereon

b. To 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

Definitions

.05 For purposes of this section, the following terms have the meanings attributed as follows:

Exempt offering document. The disclosure document that provides financial and nonfinancial information related to the entity issuing the exempt offering (or in the case of a franchise offering, the franchisor) and the offering itself. (Ref: par. .A5)

Security. *Security* has the meaning as defined in Section 2(a)(1) of the Securities Act of 1933, as amended.

.06 References in this section to an auditor's report are to be read to encompass an auditor's report on financial statements[2] or an auditor's review report on interim financial information in accordance with section 930, *Interim Financial Information*.

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[2]An auditor's report in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special*

.07 References in this section to an auditor's report that is included in an exempt offering document are to be read to also encompass an auditor's report that is incorporated by reference in an exempt offering document.

Requirements

Involvement

.08 The auditor is involved with an exempt offering document and should apply the requirements of this section in connection with an exempt offering document when both of the following conditions exist:

a. The auditor's report is included in the exempt offering document.

b. The auditor performs one or more of the following activities with respect to the exempt offering document: (Ref: par. .A6)

    i. Assisting the entity in preparing information included in the exempt offering document (Ref: par. .A7–.A10)

    ii. Reading a draft of the exempt offering document at the entity's request (Ref: par. .A11)

    iii. Issuing a comfort or similar letter in accordance with section 920, *Letters for Underwriters and Certain Other Requesting Parties*, or an agreed-upon procedures report in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*, in lieu of a comfort or similar letter on information included in the exempt offering document (Ref: par. .A12–.A14)

    iv. Participating in due diligence discussions with underwriters, placement agents, broker-dealers, or other financial intermediaries in connection with the exempt offering (Ref: par. .A15)

    v. Issuing a practitioner's attestation report on information relating to the exempt offering (Ref: par. .A16–.A17)

    vi. Providing written agreement for the use of the auditor's report in the exempt offering document (Ref: par. .A18–.A23)

    vii. Updating an auditor's report for inclusion in the exempt offering document (Ref: par. .A24–.A25)

When the auditor is involved with an exempt offering document, the auditor should perform the procedures in paragraphs .09–.15 at or shortly before the date of distribution, circulation, or submission of the exempt offering document, and as appropriate upon any subsequent distribution, circulation, or submission of the exempt offering document. (Ref: par. .A26)

Purpose Frameworks, or section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*.

Other Information Included in the Exempt Offering Document

.09 When the auditor is involved with an exempt offering document, the auditor should perform the procedures described in paragraphs .15–.23 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, adapted as necessary, on the exempt offering document. When performing those procedures, the auditor should determine that the auditor's role is not described in the exempt offering document in a way that indicates that the auditor's responsibility is greater than the auditor intends. (Ref: par. .A27–.A31) [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after December 15, 2021, by SAS No. 137.]

Subsequent Events and Subsequently Discovered Facts

.10 When the auditor is involved with an exempt offering document, the auditor should do the following:

a. Perform procedures designed to identify events occurring between the date of the auditor's report and the date of the distribution, circulation, or submission of the exempt offering document that, had they been known to the auditor as of the date of the auditor's report, may have caused the auditor to revise the auditor's report (hereafter referred to as "subsequent events" for purposes of this section). Such procedures should include the following: (Ref: par. .A32–.A35)

   i. Obtaining an understanding of any procedures that management may have performed to identify such events

   ii. Inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements

   iii. Reading minutes, if any, of the meetings of the entity's management and those charged with governance that have been held since the date of the auditor's report and inquiring about matters discussed at any such meetings for which minutes are not yet available

   iv. Reading the entity's most recent subsequent interim financial statements, if any

b. Obtain updated written representations from management about the following:

   i. Whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified

   ii. Whether any events have occurred subsequent to the date of the auditor's report that would require adjustment to, or disclosure in, the financial statements

   iii. That management provided complete minutes of the meetings of the entity's management and those charged with governance, or summaries of actions of recent meetings for which minutes have not yet been prepared since previous representations were provided

iv. That management provided communications received from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices since previous representations were provided

.11 If a predecessor auditor's report on a prior period is included in the exempt offering document but the predecessor auditor did not audit the entity's separate financial statements for the most recent audited period for which the entity's audited financial statements are included in the exempt offering document, and the predecessor auditor is involved with the exempt offering then the predecessor auditor should perform the following procedures:

a. Read the financial statements of the subsequent period to be presented on a comparative basis.

b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis.

c. Inquire of and request written representations from management of the former client, at or near the date of distribution, circulation, or submission of the exempt offering document about the following:

   i. Whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified

   ii. Whether any events have occurred subsequent to the date of the latest prior period financial statements reported on by the predecessor auditor that, had they been known to the auditor as of the date of the auditor's report, may have caused the auditor to revise the auditor's report

d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor.

.12 When a predecessor auditor of an acquired entity is involved with an exempt offering document and the acquirer's audited financial statements included in the exempt offering document reflect a time period that includes the date of acquisition, the predecessor auditor may be unable to perform all of the procedures in paragraph .11 of this section. In such circumstances, the predecessor auditor should obtain written representations from management of the former client, and a representation letter from the successor auditor as described in paragraph .11*c–d* of this section.

.13 If the auditor identifies subsequent events that may require adjustment of, or disclosure in, the audited financial statements or reviewed interim financial information, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document until the auditor's consideration of the subsequent events, including the effect on the auditor's report, has been satisfactorily evaluated in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*.[3]

.14 If the auditor becomes aware of subsequently discovered facts, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document until the auditor's consideration of the subsequently discovered facts, including the effect on the auditor's report, has been satisfactorily evaluated in accordance with section 560.[4]

.15 If management does not revise the financial statements in circumstances in which the auditor believes they need to be revised, in addition to following the requirements in section 560, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document.[5]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 Securities offerings and franchise offerings may be offered by means other than a registered offering through exemptions to registration afforded under federal or state laws and regulations based on the size and nature of the offering or the issuing entity or franchisor, as applicable. Securities offered through means other than a registration statement under the Securities Act of 1933 and franchise offerings are within the scope of this section. Exhibit A, "Examples of Exempt Offerings," provides examples of types of offerings within the scope of this section. Section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, addresses the auditor's responsibilities when financial statements of a nonissuer are included or incorporated by reference in a registration statement under the Securities Act of 1933.

.A2 Auditors may include a provision in the terms of the engagement requiring the entity to obtain permission from the auditor before using the auditor's report in connection with an exempt offering document. The existence of such a provision in an engagement letter does not establish involvement unless the auditor performs one or more of the activities in paragraph .08*b* with respect to the exempt offering document. An example provision for an engagement letter may read as follows:

> The Entity may wish to include our report on these financial statements in an exempt offering document. The Entity agrees that the aforementioned auditor's report, or reference to our Firm, will not be included in any such offering document without our prior permission or consent. Any agreement to perform work in connection with an exempt offering document, including an agreement to provide permission or consent, will be a separate engagement.

[3] Paragraph .11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

[4] Paragraphs .15–.18 of section 560.

[5] Paragraphs .17–.18 of section 560.

.A3 The auditor may include in the terms of the engagement a provision that any exempt offering document issued by the entity with which the auditor is not involved, other than as determined by paragraph .08, will clearly indicate the auditor is not involved with the contents of such offering document. An example disclosure related to an exempt offering document may read as follows:

> [*Name of Firm*], our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. [*Name of Firm*] also has not performed any procedures relating to this offering document.

Effective Date (Ref: par. .03)

.A4 Some exempt offerings have multiple stages, for example distribution of a preliminary offering document and a final offering document. For such exempt offerings, the effective date relates to the distribution, circulation, or submission of the initial exempt offering document on or after June 15, 2018. Other exempt offerings, such as franchise offerings, may be updated annually. For such exempt offerings, the effective date relates to the initial or updated exempt offering document distributed, circulated, or submitted on or after June 15, 2018.

Definitions (Ref: par. .05)

.A5 An exempt offering document may also be referred to as an offering statement, offering memorandum, offering circular, or a franchise disclosure document.

Involvement

Performance of Activities (Ref: par. .08b)

.A6 Auditors may become aware of an offering through a communication from an entity or through the receipt of a draft exempt offering document from an underwriter, placement agent, broker-dealer, or the entity. Awareness of an exempt offering by the auditor does not, by itself, constitute involvement.

Assisting in Preparing Information (Ref: par. .08bi)

.A7 Assistance in preparing information as described in paragraph .08*b*i is predicated upon the auditor being reasonably aware that the information will be included in a specific exempt offering document. For example, an auditor assisting the entity with the preparation of a schedule for the entity's internal purposes that the entity later includes in an exempt offering document would not be considered assisting the entity in preparing information as described in paragraph .08*b*i.

.A8 Information does not include the audited financial statements or interim financial information covered by the auditor's report. Further, information does not include required supplementary information, or other information that accompanied those financial statements that the auditor already considered during the audit of the financial statements or review of interim financial information.

.A9 Self-review, management participation, and advocacy threats to a covered member's compliance with the AICPA Code of Professional Conduct may exist when a member provides corporate finance consulting services to an entity.[6] A member may assist the entity in drafting its exempt offering document or memorandum without impairing independence[7] if the member complies with the AICPA Code of Professional Conduct.[8,9]

.A10 Providing written or oral comments to the entity on the exempt offering document is considered assisting the entity in preparing information included in the exempt offering document, regardless of whether the entity requested the auditor to read the document or the auditor did so voluntarily.

Reading a Draft of the Exempt Offering Document (Ref: par. .08bii)

.A11 Reading a draft of the exempt offering document encompasses situations in which the auditor reads the exempt offering document at the request of the entity even if the auditor does not ultimately provide written or oral comments.

Issuing a Comfort or Similar Letter or an Agreed-Upon Procedures Report in Accordance With AT-C Section 215 (Ref: par. .08biii)

.A12 Underwriting agreements between an entity and its underwriters may include a request for the entity's auditor to prepare and issue a comfort letter that will assist the underwriters with their due diligence in connection with the exempt offering. Comfort letters may also be requested by parties other than the underwriters. Section 920 addresses the auditor's responsibilities related to the issuance of comfort letters.

.A13 An auditor may issue a comfort letter that provides negative assurance to a requesting party (as defined in section 920) only if the requesting party provides the written opinion from external legal counsel or the required representation letter described in section 920.[10] If the requesting party does not provide the required written opinion from external legal counsel or a representation letter, the auditor may issue a similar letter that does not provide negative assurance, but that instead includes certain statements required by section 920.[11]

.A14 When a comfort letter is requested by a party other than a requesting party as defined in section 920, the auditor should not provide that party with a comfort letter or

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[6]The "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct.

[7]The "Corporate Finance Consulting" interpretation (ET sec. 1.295.130.02*f*) of the "Nonattest Services" subtopic (ET sec. 1.295) under the "Independence Rule" of the AICPA Code of Professional Conduct.

[8]The "General Requirements for Performing Nonattest Services" interpretation (ET sec. 1.295.040) of the "Nonattest Services" subtopic under the "Independence Rule."

[9]The "Corporate Finance Consulting" interpretation (ET sec. 1.295.130.03) of the "Nonattest Services" subtopic under the "Independence Rule" also lists examples of types of corporate finance consulting services that would impair a member's independence in connection with an offering.

[10]Paragraphs .07, .11, and .A92 of section 920, *Letters for Underwriters and Certain Other Requesting Parties*.

similar letter described in section 920.[12] Instead, the auditor may accept an engagement to perform agreed-upon procedures requested by that party in accordance with the attestation standards and may issue a practitioner's report.[13]

Participating in Due Diligence Discussions (Ref: par. .08biv)

.A15 As part of their due diligence process, underwriters and their counsel may ask to meet with the entity's auditors and discuss the specific exempt offering, either formally or informally.[14] Such meetings are often referred to as oral due diligence meetings; however, other communication methods may be used. The discussion typically focuses on the audit engagement, the entity's financial statements, and the entity's system of internal control over financial reporting. Auditors use professional judgment in determining whether to participate in due diligence discussions if the underwriter has not provided the written opinion from external legal counsel or representation letter as described in section 920.[15] If the auditor agrees to participate, auditors use professional judgment in determining which questions in an oral due diligence meeting can be addressed.

Issuing a Practitioner's Attestation Report on Information Relating to the Exempt Offering (Ref: par. .08bv)

.A16 During the offering process, management or other parties to the offering may engage a practitioner to perform an attestation engagement on information related to the offering. For example, in an exempt debt offering, management or its legal advisers may engage a practitioner to perform agreed-upon procedures on the entity's compliance with the revenue coverage requirements on outstanding debt securities or to recompute the calculation of escrow account requirements for an advance refunding of debt securities. If the practitioner engaged to perform the attestation engagement is the auditor whose report accompanies the financial statements included in the exempt offering document, the auditor is deemed to be involved with the exempt offering document. A practitioner's attestation report relating to an exempt offering need not be referred to or included in the exempt offering document to involve the auditor of the financial statements with the offering.

.A17 If the practitioner engaged to perform the attestation engagement is not the financial statement auditor, the practitioner engaged to perform the attestation engagement is not deemed to be involved with the exempt offering document in the manner described in this section.

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[11]Paragraph .12 and example Q, "Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11," of exhibit B, "Examples of Comfort Letters," of section 920.

[12]Paragraph .13 of section 920.

[13]AT-C section 215, *Agreed-Upon Procedures Engagements.*

[14]The "Confidential Client Information Rule" (ET sec 1.700.001) of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client.

[15]Paragraphs .07, .11, and .A92 of section 920.

Providing Written Agreement for the Use of the Auditor's Report in the Exempt Offering Document (Ref: par. .08bvi)

.A18 For securities exempt from registration under the Securities Act of 1933, it may not be necessary for the auditor to provide any type of written agreement. If the auditor is asked to provide written agreement, the auditor may provide an inclusion letter indicating that the auditor agrees to the inclusion of the auditor's report in the exempt offering document.

.A19 An inclusion letter is a letter requested by and addressed to the entity that is signed and dated by the auditor indicating that the auditor agrees to the inclusion or incorporation by reference of the auditor's report in the exempt offering document.

.A20 For securities exempt from registration under the Securities Act of 1933, an inclusion letter may also be referred to as an *agree-to-include letter*, an *acknowledgement letter*, or an *awareness letter*. Note that *awareness letter* is defined in section 925 with a different meaning in that context.

.A21 The following example language may be used to indicate that the auditor agrees to inclusion of the auditor's report on financial statements in an exempt offering document:

Independent Auditor's Inclusion Letter

We agree to the inclusion [*or* incorporation by reference] in the [*name of Offering Document*] dated [*insert issuance date of Offering Document*] of our report, dated [*insert date of auditor's report on the financial statements*], on our audit of the financial statements of [*name of Entity*] as of December 31, 20X2 [and 20X1], and for the year[s] then ended.

.A22 For franchise offerings regulated by the FTC, certain states may require a *consent of accountant* which may also be referred to as an *acknowledgement letter*.

.A23 The following example language may be used to indicate the auditor's agreement to the inclusion of the auditor's report on financial statements in a franchise offering document:

Independent Auditor's Acknowledgment

We agree to the inclusion in the [*name of Offering Document*, for example the Franchise Disclosure Document] dated [*issuance date of Offering Document*] issued by [*name of Franchisor*] ("the Franchisor") of our report, dated [*insert date of auditor's report on the financial statements*], relating to the financial statements of the Franchisor as of December 31, 20X2 [and 20X1], and for the year[s] then ended.

Updating an Auditor's Report for Inclusion in the Exempt Offering Document (Ref: par. .08bvii)

.A24 Updating an auditor's report involves, for example, signing an updated auditor's report when the previously issued financial statements are corrected for an accounting error or reflect a retrospective application of a change in accounting principle.

.A25 The following examples would not constitute updating an auditor's report for purposes of paragraph .08*b*vii:

- Providing a copy of or re-signing a previously issued auditor's report
- Revising an originally issued auditor's report to eliminate references made by the auditor in the original report required by *Government Auditing Standards*
- Revising an originally issued report to eliminate references made by the auditor in the original report to supplementary information that the auditor reported on in relation to the basic financial statements

Distribution, Circulation, or Submission (Ref: par. .08)

.A26 As discussed in paragraph .A4, exempt offerings may have multiple stages. Thus, a single offering could involve multiple applications of this section. Requesting management to keep the auditor advised of the progress of the preparation of the exempt offering document proceedings through the final distribution, circulation, or submission of the final exempt offering document is important so that the auditor's consideration of events occurring after the date of the auditor's report up to the distribution, circulation, or submission of the final exempt offering document can be completed.

Other Information Included in the Exempt Offering Document (Ref: par. .09)

.A27 When revision of the other information in the exempt offering document is necessary due to a material misstatement that management refuses to correct, section 720 requires the auditor to communicate the matter with those charged with governance and request that the correction be made. If the other information is not corrected after communicating with those charged with governance, the auditor is required to take appropriate action in accordance with paragraph .21 of section 720. With regard to exempt offerings, actions may also include determining whether to withhold the auditor's agreement to include the auditor's report. In such cases, the auditor may consider it appropriate to obtain legal advice. [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after December 15, 2021, by SAS No. 137.]

References to the Auditor as an "Expert"

.A28 The term *expert* has a specific statutory meaning under the Securities Act of 1933. Outside the Securities Act of 1933 context, the term *expert* is typically undefined. Accordingly, except as described in paragraph .A31 of this section, when an entity wishes to make reference to the auditor's role in connection with an exempt offering, the caption to that section of the document would generally be titled "Independent Auditors" (or something similar) rather than "Experts," with no reference to the auditor as an expert anywhere in the exempt offering document.

.A29 The following is an example of a typical description of the auditor's role when an entity wishes to make reference to the auditor in an exempt offering document:

> **Independent Auditors**
>
> The financial statements of [*name of Entity*] as of December 31, 20X2 [and 20X1], and for the year[s] then ended, included in this offering document, have been audited by [*name of Firm*], independent auditors, as stated in their report appearing herein.

.A30 If the entity refuses to delete references to the auditor as an "expert," the auditor may consider whether to withhold permission to include the auditor's report in the exempt offering document, based on the auditor's professional judgment. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

.A31 In situations in which the term *expert* is sufficiently defined the auditor may agree to be referred to as an expert outside the context of a registration statement filed under the Securities Act of 1933, as amended. For example, if the term *expert* is defined under applicable state law, the auditor may agree to be named as an expert in an exempt offering document in an intrastate offering. An understanding of any auditor liability provisions that may be included in the applicable federal or state statutes is an important consideration. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

Subsequent Events and Subsequently Discovered Facts (Ref: par. .10–.15)

.A32 The general objective of the subsequent event procedures described in this section is to identify subsequent events or act upon any subsequently discovered 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. After financial statements have been issued or are available to be issued, the accounting framework pursuant to which they were prepared may not require accounting for or disclosure of events occurring after that date. Financial statements included in an exempt offering document may have previously been issued; accordingly, the auditor's subsequent event procedures are performed to update the auditor's awareness of the existence of any events or facts that may cause revision to the financial statements, including disclosures, or the auditor's report thereon through the date of distribution, circulation, or submission of the exempt offering document.

.A33 When applying the procedures described in paragraphs .11–.15 of this section, the auditor may consider the application and other explanatory material in section 560.

.A34 An illustrative updating management representation letter is included in section 580, *Written Representations*.[16]

Considerations Specific to Governmental Entities

.A35 In determining the extent of subsequent event procedures to perform in connection with a governmental debt offering, and the related management representations to request as addressed in paragraph .10*b* of this section, the auditor may consider the structure of the government and which component units relate to the debt offering. A component unit not guaranteeing the repayment is ordinarily not a relevant entity to the users of the debt offering. Alternatively, if the debt is offered solely by a particular component unit, the scope of subsequent event procedures would likely be limited to the applicable component unit responsible for the repayment of the debt. However, if the full set of financial statements for the reporting entity were included in the exempt offering document, the scope of subsequent event procedures would likely also encompass the primary government.

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[16]Exhibit C, "Illustrative Updating Management Representation Letter," of section 580, *Written Representations*.

Exhibit A — Examples of Exempt Offerings (Ref: par. .A1)

.A36

1. The Securities Act of 1933 provides for two broad types of exemptions to the requirement that securities be registered with the SEC under Section 5 of the 1933 Act: exempt securities (under Section 3 of the 1933 Act) and exempt transactions (generally under Sections 4 and 4A of the 1933 Act. With Section 3 exempt securities, the exemption lies with the nature of the security, and thus each transaction involving that security will itself be exempt. With Section 4 exempt transactions, however, the exemption is applicable only to a single transaction, and does not necessarily carry over to subsequent transactions. Each transaction involving that security must be analyzed to determine if it too is exempt from Section 5 registration requirements. The following list is not intended to be comprehensive. The exemptions listed are frequently subject to conditions and definitional limitations that are not summarized here.

Exempt Securities

2. Examples of exempt securities (subject to conditions and, in some cases, restrictive definitions) include the following:

- Securities issued or guaranteed by federal, state, and local governments, including most industrial development bonds (Section 3(a)(2))
- Any security issued or guaranteed by banks or employee benefit plans (Section 3(a)(2))
- Short-term commercial paper with a maturity of nine months or less (Section 3(a)(3))
- Securities issued by non-profit religious, educational or charitable organizations (Section 3(a)(4))
- Securities issued by savings and loans and farmer's cooperatives (Section 3(a)(5))
- Railroad equipment trusts (Section 3(a)(6))
- Certificates of receivers and trustees issued with court approval (Section 3(a)(7))
- Insurance policies and annuity contracts (Section 3(a)(8))
- Equity securities issued in connection with the acquisition by a bank holding company of a bank or savings association (Section 3(a)(12))
- Securities issued by certain church employee plans (Section 3(a)(13))
- Security futures products and standardized options (Section 3(a)(14))

Exempt Transactions

3. Examples of exempt transactions include the following:

- Transactions by any person other than an issuer, underwriter, or dealer (Section 4(a)(1))
- Transaction by an entity not involving any public offering (the "private placement" exemption), including offerings under Regulation D Rule 506 and Rule 144A (Section 4(a)(2))
- Transactions by a dealer, with certain exceptions (Section 4(a)(3))
- Brokers' transactions executed on customer orders (Section 4(a)(4))
- Offers or sales by an entity to accredited investors (under certain conditions) (Section 4(a)(5))
- Regulation CF transactions (crowdfunding) (Section 4(a)(6))
- Private resales of securities (Section 4(a)7))
- Small issues of securities, including Regulation A offerings and offerings under Rules 504 and 505 of Regulation D (Section 3(b) and Section 3(c))
- Voluntary exchanges between an entity and security holders (Section 3a)(9))
- Judicially or administratively approved exchanges (Section 3a)(10))
- Intrastate offerings (Section 3(a)(11))

Other Common Exemptions

4. Examples of other common exemptions include these:

- Rule 701 exemptions for compensatory arrangements
- Regulation S (offshore offers and sales)

Franchise Offerings

5. Franchise offerings are regulated at the federal and state level. Federal regulation occurs through the FTC under the *Disclosure Requirements and Prohibitions Concerning Franchising* (the FTC rule). The FTC rule requires franchisors to provide a franchise disclosure document to each prospective buyer, but does not require franchise disclosure documents to be filed or registered with the FTC. At the state level, regulations vary widely. Some states have franchise statutes and regulations that are more stringent than the FTC requirements, and which may require a franchisor to file or register its offering with state franchise authorities.

AU-C Appendixes

AU-C Appendix A

Historical Background

In 1917, the American Institute of Certified Public Accountants, then known as the American Institute of Accountants, at the request of the Federal Trade Commission, prepared "a memorandum on balance-sheet audits," which the Federal Trade Commission approved and transmitted to the Federal Reserve Board.

The Federal Reserve Board, after giving the memorandum its provisional endorsement, published it in the *Federal Reserve Bulletin* of April 1917; reprints were widely disseminated for the consideration of "banks, bankers, banking associations; merchants, manufacturers, and associations of manufacturers; auditors, accountants, and associations of accountants" in pamphlet form with the title of "Uniform Accounting: a Tentative Proposal Submitted by the Federal Reserve Board."

In 1918, it was reissued under the same sponsorship, with a new title "Approved Methods for the Preparation of Balance-Sheet Statements." There was practically no change from 1917 except that, as indicated by the respective titles and corresponding change in the preface, instead of the objective of "a uniform system of accounting to be adopted by manufacturing and merchandising concerns," the new objective was "the preparation of balance-sheet statements" for the same businesses.

In 1929, a special committee of the Institute undertook revision of the earlier pamphlet in the light of the experience of the past decade; again under the auspices of the Federal Reserve Board, the revised pamphlet was issued in 1929 as "Verification of Financial Statements."

The preface of the 1929 pamphlet spoke of its predecessors as having been criticized, on the one hand, by some accountants for being "more comprehensive than their conception of the so-called balance-sheet audit," and, on the other hand, by other accountants because "the procedure would not bring out all the desired information." This recognition of opposing views evidenced the growing realization of the impracticability of uniform procedures to fit the variety of situations encountered in practice. Of significance is the appearance in the opening paragraph of "General Instructions" in the 1929 publication of the statement:

The extent of the verification will be determined by the conditions in each concern. In some cases, the auditor may find it necessary to verify a substantial portion or all of the transactions recorded upon the books. In others, where the system of internal check is good, tests only may suffice. The responsibility for the extent of the work required must be assumed by the auditor.

Between 1932 and 1934, there was correspondence, dealing with both accounting and auditing matters, between the Institute's special committee on cooperation with stock exchanges and the committee on stock list of the New York Stock Exchange. The views expressed were an important development in the recognition of the position of accountancy in finance and business. The series of letters was published in 1934 under the title *Audits of Corporate Accounts*.

In 1936, a committee of the Institute prepared and published a further revision of the earlier pamphlets under the title of "Examination of Financial Statements by Independent Public Accountants." The Institute availed itself of the views of persons outside the ranks of the profession whose opinions would be helpful, but the authority behind and responsibility for the publication of the pamphlet rested wholly with the Institute as the authoritative representative of a profession that had by that time become well established in the business community.

In the 1936 revision, aside from the very briefly noted "Modifications of Program for Larger or Smaller Companies," the detailed procedures were restrictively stated to be an "outline of examination of financial statements of a small or moderate size company." Moreover, the nature and extent of such examinations were based on the purpose of the examination, the required detail to be reported on, the type of business, and, most important of all, the system of internal control; variations in the extent of the examination were specifically related to "the size of the organization and the personnel employed" and were said to be "essentially a matter of judgment which must be exercised by the accountant."

It is possible from the foregoing narrative to trace the development of the profession's view of an audit based on the experience of three decades. The succession of titles is illustrative. The earliest ambition for "uniform accounting" was quickly realized to be unattainable, and the same listed procedures were related instead to "balance-sheet statements." Then, with the gradually greater emphasis on periodic earnings, the earlier restrictive consideration of the balance sheet was superseded in the 1929 title, "Verification of Financial Statements," by according the income statement at least equal status. When in turn the 1936 revision was undertaken, there was a growing realization that, with the complexity of modern business and the need of the independent auditor to rely on testing, such a word as "verification" was not an accurate portrayal of the independent auditor's function. Accordingly, the bulletin of that year was stated to cover an "examination" of financial statements.

Statements on Auditing Procedure

The Committee on Auditing Procedure had its beginning on January 30, 1939, when the executive committee of the Institute authorized the appointment of a small committee "to examine into auditing procedure and other related questions in the light of recent public discussion."

On May 9 of that year, the report "Extensions of Auditing Procedure" of this special committee was adopted by the Council of the Institute and authority given for its publication and distribution, and in the same year the bylaws were amended to create a standing Committee on Auditing Procedure.

In 1941, the executive committee authorized the issuance to Institute members, in pamphlet form, of the Statements on Auditing Procedure, prepared by the Committee on Auditing Procedure, previously published only in *The Journal of Accountancy*.

The Statements on Auditing Procedure were designed to guide the independent auditor in the exercise of his judgment in the application of auditing procedures. In no sense were they intended to take the place of auditing textbooks; by their very nature textbooks must deal in a general way with the description of procedures and refinement of detail rather than the variety of circumstances encountered in practice that require the independent auditor to exercise his judgment.

Largely to meet this need, the Institute began the series of Statements on Auditing Procedure. The first of these presented the report of the original special committee, as modified and approved, at the Institute's annual meeting on September 19, 1939, and issued under the title of "Extensions of Auditing Procedure."

Statement No. 1 presented conclusions drawn from the experience and tradition of the profession which largely furnished the foundation for the Committee's present structural outline of auditing standards; the other Statements on Auditing Procedure appropriately fit into that structural outline.

The "Codification of Statements on Auditing Procedure" was issued by the Committee on Auditing Procedure in 1951 to consolidate the features of the first 24 pronouncements, which were of continuing usefulness.

When the SEC adopted the requirement that a representation on compliance with generally accepted auditing standards be included in the independent auditor's report on financial statements filed with the SEC, it became apparent that a pronouncement was needed to define these standards. Accordingly, the Committee on Auditing Procedure undertook a special study of auditing standards (as distinguished from auditing procedures) and submitted a report that was published in October 1947 under the title "Tentative Statement of Auditing Standards—Their Generally Accepted Significance and Scope." The recommendations of this brochure ceased to be tentative when, at the September 1948 meeting, the membership of the Institute approved the summarized statement of auditing standards.

In 1954 the tentative brochure was replaced by the booklet *Generally Accepted Auditing Standards—Their Significance and Scope*, which was issued as a special report of the Committee on Auditing Procedure. This pronouncement also gave recognition to the approval of Statement on Auditing Procedure No. 23 (Revised), *Clarification of Accountant's Report When Opinion Is Omitted* (1949) and the issuance of the codification (1951).

Statement on Auditing Procedure No. 33 was issued in 1963 as a consolidation of, and a replacement for, the following pronouncements of the Committee on Auditing Procedure: *Internal Control* (1949), *Generally Accepted Auditing Standards* (1954), *Codification of Statements on Auditing Procedure* (1951), and Statements on Auditing Procedure Nos. 25–32, which were issued between 1951 and 1963. Statement No. 33 was a codification of earlier committee pronouncements that the committee believed to be of continuing interest to the independent auditor.

Statements on Auditing Standards

After issuance of Statement on Auditing Procedure No. 33, 21 additional Statements on Auditing Procedure, Nos. 34–54, were issued by the Committee on Auditing Procedure. In November 1972, these pronouncements were codified in Statement on Auditing Standards (SAS) No. 1, *Codification of Auditing Standards and Procedures*. Also, in 1972, the name of the committee was changed to the Auditing Standards Executive Committee to recognize its role as the AICPA's senior technical committee charged with interpreting generally accepted auditing standards.

The Auditing Standards Executive Committee issued 22 additional statements through No. 23. These statements were incorporated in this publication, which provides a continuous codification of SASs.

Creation of the Auditing Standards Board

As a result of the recommendations of the Commission on Auditors' Responsibilities, an independent study group appointed by the AICPA, a special committee was formed to study the structure of the AICPA's auditing standard-setting activity. In May 1978, the AICPA Council adopted the recommendations of that committee to restructure the Committee. Accordingly, in October 1978 the Auditing Standards Board (ASB) was formed as the successor to prior senior technical committees on auditing matters. The ASB was given the following charge:

The AICPA Auditing Standards Board shall be responsible for the promulgation of auditing standards and procedures to be observed by members of the AICPA in accordance with the Institute's rules of conduct.

The board shall be alert to new opportunities for auditors to serve the public, both by the assumption of new responsibilities and by improved ways of meeting old ones, and shall as expeditiously as possible develop standards and procedures that will enable the auditor to assume those responsibilities.

Auditing standards and procedures promulgated by the board shall—

a. Define the nature and extent of the auditor's responsibilities.

b. Provide guidance to the auditor in carrying out his duties, enabling him to express an opinion on the reliability of the representations on which he is reporting.

c. Make special provision, where appropriate, to meet the needs of small enterprises.

d. Have regard to the costs which they impose on society in relation to the benefits reasonably expected to be derived from the audit function.

The Auditing Standards Board shall provide auditors with all possible guidance in the implementation of its pronouncements, by means of interpretations of its statements, by the issuance of guidelines, and by any other means available to it.

Changes Created by Sarbanes-Oxley Act of 2002

AICPA members who perform auditing and other related professional services have been required to comply with SASs promulgated by the AICPA ASB. These standards constitute what is known as generally accepted auditing standards (GAAS). Prior to Sarbanes-Oxley, the ASB's auditing standards have applied to audits of all entities.

However, as a result of the passage of the Sarbanes-Oxley Act of 2002 (the Act), the PCAOB was designated as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act. Public accounting firms auditing those entities are required to be registered with the PCAOB and to adhere to all PCAOB rules and standards in those audits. In 2003, the PCAOB adopted the then-existing Audit and Attest Standards as its interim auditing standards.

The preparation and issuance of audit reports for those entities not subject to the Act, as amended, (that is, those audits that are not within the PCAOB's jurisdiction) continue to be governed by GAAS promulgated by the ASB.

The Reconstituted ASB

In February 2004, the AICPA's Board of Directors unanimously recommended that the AICPA's Governing Council take the following action at its meeting in May 2004:

- Designate the PCAOB as a body with the authority to promulgate auditing and related attestation standards, quality control, ethics, independence, and other standards relating to the preparation and issuance of audit reports for entities as defined by the Act, as amended.
- Amend the ASB's current designation to recognize the ASB as a body with the authority to promulgate auditing, attestation, and quality control standards relating to the preparation and issuance of audit reports for entities not within the PCAOB's jurisdiction.

As a result of this action, the ASB was reconstituted and its jurisdiction amended by AICPA Council to recognize the ASB as a body with the authority to promulgate auditing, attestation and quality control standards relating to the preparation and issuance of audit and attestation reports for entities not within the PCAOB's jurisdiction.

U.S. Auditing Standards — AICPA (Clarified)

In October 2011, the ASB issued SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which was the culmination of a multiyear Clarity Project to clarify the SASs and converge them with the International Standards on Auditing. Beginning with SAS No. 122, all new SASs are now included in the section *U.S. Auditing Standards—AICPA (Clarified)*. SAS No. 122 is effective for audits of financial statements for periods ending on or after December 15, 2012. Refer to individual AU-C sections for specific effective date language.

AU-C Appendix B

Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards

200–299	GENERAL PRINCIPLES AND RESPONSIBILITIES
ISA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
ISA 210	Agreeing the Terms of Audit Engagements
ISA 220 (Revised)	Quality Control for an Audit of Financial Statements
ISA 230	Audit Documentation
ISA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
ISA 250 (Revised)	Consideration of Laws and Regulations in an Audit of Financial Statements
ISA 260 (Revised)	Communication with Those Charged with Governance
ISA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
300–499	**RISK ASSESSMENT AND RESPONSE TO ASSESSED RISKS**
ISA 300	Planning an Audit of Financial Statements
ISA 315 (Revised 2019)	Identifying and Assessing the Risks of Material Misstatement
ISA 320	Materiality in Planning and Performing an Audit
ISA 330	The Auditor's Responses to Assessed Risks
ISA 402	Audit Considerations Relating to an Entity Using a Service Organization
ISA 450	Evaluation of Misstatements Identified during the Audit
500–599	**AUDIT EVIDENCE**
ISA 500	Audit Evidence
ISA 501	Audit Evidence — Specific Considerations for Selected Items
ISA 505	External Confirmations
ISA 510	Initial Audit Engagements — Opening Balances
ISA 520	Analytical Procedures
ISA 530	Audit Sampling
ISA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
ISA 550	Related Parties
ISA 560	Subsequent Events
ISA 570 (Revised)	Going Concern

ISA 580	Written Representations
600–699	**USING THE WORK OF OTHERS**
ISA 600	Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)
ISA 610 (Revised 2013)	Using the Work of Internal Auditors (Revised 2013)
ISA 620	Using the Work of an Auditor's Expert
700–799	**AUDIT CONCLUSIONS AND REPORTING**
ISA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements
ISA 701	Communicating Key Audit Matters in the Independent Auditor's Report
ISA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report
ISA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
ISA 710	Comparative Information — Corresponding Figures and Comparative Financial Statements
ISA 720 (Revised)	The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements
800–899	**SPECIALIZED AREAS**
ISA 800 (Revised)	Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
ISA 805 (Revised)	Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
ISA 810 (Revised)	Engagements to Report on Summary Financial Statements

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between the Statements on Auditing Standards and International Standards on Auditing, and the rationales therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on, or reviewed by, the Auditing Standards Board.

Statements on Auditing Standards (SASs) are issued by the Auditing Standards Board (ASB), the senior committee of the AICPA designated to issue pronouncements on auditing matters for nonissuers.[1] The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit of a nonissuer to comply with standards promulgated by the ASB.

The ASB has a strategic objective to converge its standards with those developed by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). Each SAS differs from its corresponding ISA only where the ASB believes compelling reasons exist for the differences. As described in this appendix, nearly all ISA requirements are also requirements of auditing standards generally accepted in the United States of America (GAAS). The ASB also has a strategic objective of

[1]See the definition of the term *nonissuer* in the AU-C Glossary. [Footnote revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

minimizing unnecessary differences with the auditing standards of the PCAOB. Accordingly, GAAS contain additional requirements that address issues specific to the United States of America or that have been retained from previous SASs.

An AICPA member practicing in the United States of America may be engaged to audit the financial statements of a nonissuer in accordance with the ISAs. In those circumstances where the auditor's report states that the audit was conducted in accordance with the ISAs, the U.S. auditor should comply with both the ISAs and, as required by the AICPA Code of Professional Conduct, GAAS. An engagement of this nature is normally conducted by performing an audit in accordance with GAAS plus performing any additional procedures required by the ISAs.

The purpose of this appendix is to assist the U.S. auditor in planning and performing an engagement in accordance with the ISAs. This document provides a brief description of how each ISA differs from the comparable U.S. standard. However, to fully understand how the ISA might affect the nature, timing, and extent of the procedures performed in an engagement in accordance with GAAS, the auditor should consider the ISAs in their entirety by considering the standards together with the related guidance included in the ISAs. In performing an audit in accordance with the ISAs, the auditor also needs to comply with the International Ethics Standards Board for Accountants' (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)*.

This analysis compares the ISAs included in the 2021 edition of the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, to the AICPA's *Professional Standards*, as of May 2022. References to GAAS are made to the relevant AU-C sections. This analysis describes the differences in terms of

a. differences in wording,

b. requirements in the ISAs not in GAAS,

c. requirements in GAAS not in the ISAs,

d. differences between requirements, and

e. the placement of certain requirements within GAAS

General

In converging with the ISAs, the ASB has made various changes to the wording of the ISAs throughout the SASs. Such changes have been made to use terms applicable in the United States and to make the SASs easier to read and apply in the United States. The ASB believes that such changes do not create differences between the application of the ISAs and the application of GAAS. Selected changes are described in the analysis that follows.

ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, Compared to Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

Requirements in the ISAs Not in GAAS

The ISAs provide for reporting on financial statements that are prepared in accordance with fair presentation financial reporting frameworks and compliance financial reporting frameworks. In the ISAs, compliance frameworks do not necessarily require fair presentation. GAAS address reporting on financial statements that are prepared in accordance with fair presentation frameworks only, because the ASB believes that in the United States, users of financial statements expect all fair presentation frameworks to be fair presentation financial reporting frameworks.

Requirements in GAAS Not in the ISAs

GAAS, as described in paragraph .25 of section 200, contain two categories of professional requirements: unconditional requirements and presumptively mandatory requirements. Paragraph .25 of section 200 describes the auditor's obligation to comply with (1) an unconditional requirement in all cases where such requirement is relevant, and (2) a presumptively mandatory requirement in all cases where such a requirement is relevant except in rare circumstances. The ISAs contain only one category of professional requirements, with which paragraphs 22–23 of ISA 200 require the auditor to comply when such requirements are relevant except in rare circumstances. The ASB retained two categories of professional requirements so as not to create unnecessary differences with the application of the auditing standards promulgated by the PCAOB, which contain the same two categories of professional requirements as described in section 200.

Paragraphs .27–.28 of section 200 contain requirements relating to interpretive publications and other auditing publications. The ISAs do not address interpretive publications or other auditing publications.

ISA 210, *Agreeing the Terms of Audit Engagements*, Compared to Section 210A, *Terms of Engagement*

Requirements in the ISAs Not in GAAS

Paragraphs 11–12 of ISA 210 contain requirements relating to situations when law or regulation prescribes management's responsibilities. Paragraph 18 of ISA 210 contains requirements relating to situations when law or regulation supplements financial reporting standards established by an authorized or recognized standards-setting organization. The ASB believes that these situations are not applicable to nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Requirements in GAAS Not in the ISAs

Paragraphs .11–.12 of section 210A address the auditor's communications with predecessor auditors in initial audit or reaudit engagements. ISA 210 does not contain these requirements. The ASB believes these requirements and related application material are appropriate for inclusion in GAAS.

Paragraph 13 of ISA 210 requires that for recurring audits, the auditor should assess whether there is a need to remind the entity of the existing terms of the engagement. Paragraph .13 of section 210A requires the auditor to remind the entity of the existing terms of the engagement and to document the reminder. The ASB believes that it is important to review the terms of the engagement with the entity each year.

Placement of Certain Requirements Within GAAS

Paragraphs 19–20 of ISA 210 contain requirements relating to situations when the financial reporting framework is prescribed by law or regulation. These requirements are addressed in section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. The different placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, Compared to Section 220, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*

Requirements in the ISAs Not in GAAS

Paragraph 21 of ISA 220 contains requirements relating to audits of listed entities. Such requirements are not applicable to audits of nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Differences Between Requirements

Paragraph .36*d* of section 220 requires that when an engagement quality review is performed, the engagement quality review be completed before the engagement partner releases the auditor's report. Paragraph 36(d) of ISA 220 requires that the quality review be completed before the engagement partner dates the auditor's report. The ASB believes that the flexibility of using the report release date provides greater benefit than the logistical cost of restricting the time available for completing the engagement quality review. As noted in the application material to section 220, when the engagement quality review results in additional procedures being performed, the date of the report would be changed.

ISA 230, *Audit Documentation*, Compared to Section 230, *Audit Documentation*

Requirements in GAAS Not in the ISAs

Paragraph .10 of section 230 requires the auditor to include abstracts or copies of significant contracts or agreements in documentation of auditing procedures related to inspection of those significant contracts or agreements. ISA 230 does not require the auditor to include abstracts or copies of the entity's records. Paragraph A3 of ISA 230 (which is application material relating to the requirement in paragraph 8 of ISA 230, which corresponds to paragraph .08 in section 230) states, "the auditor may include abstracts or copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation."

When performing auditing procedures related to inspection of significant contracts or agreements, the ASB believes that, in the context of the preparation of audit documentation that is sufficient to enable an experienced auditor to understand the audit evidence obtained, it is important to include abstracts or copies of such contracts or agreements. Further, the PCAOB standards include a requirement that documentation of auditing procedures related to the inspection of significant contracts or agreements should include abstracts or copies of the documents.[2] The ASB does not want to create a difference with PCAOB standards in this regard.

Differences Between Requirements

Paragraph 14 of ISA 230 requires the auditor to assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report, and the related application and other explanatory material indicates that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. Paragraph .16 of section 230 requires the auditor to assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date. The auditor is required by paragraph .15 of section 230 to document the report release date in the audit documentation.

Paragraph 15 of ISA 230 requires that after the assembly of the final audit file has been completed, the auditor not delete or discard audit documentation of any nature before the end of its retention period. Paragraph A23 of ISA 230 states, "the retention period for audit engagements is ordinarily no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report." Paragraph .17 of section 230 requires that after the documentation completion date, the auditor not delete or discard audit documentation before the end of the specified retention period, and goes on to state

[2] Paragraph 10 of PCAOB Auditing Standard No. 3, *Audit Documentation*.
All AS sections can be found in AICPA *PCAOB Standards and Related Rules*.

that "such retention period, however, should not be shorter than five years from the report release date."

The ASB believes that it is appropriate to be consistent with the standards of the PCAOB in relation to the date from which the documentation completion and retention periods are measured.[3] Notwithstanding that the documentation completion period is measured from the same date in GAAS and in the PCAOB standard, the ASB continues to believe that a 60-day period is appropriate for GAAS as opposed to the 45-day period in the PCAOB standard.

ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Compared to Section 240, *Consideration of Fraud in a Financial Statement Audit*

Differences in Wording

Paragraph 12 of ISA 240 and paragraph .11 of section 240 define *fraud*. However, the definition of fraud in paragraph .11 of section 240 was revised by changing the words "to obtain an unjust or illegal advantage" to "results in a misstatement in financial statements that are the subject of an audit." The ASB believes that (*a*) the definition in ISA 240 is too broad and could inappropriately expose auditors to additional liability in the United States, and (*b*) the meaning of *unjust* could be interpreted very broadly and subjectively in its application and could imply a scope well beyond the intent of the standard.

In addition, paragraph .11 of section 240 includes the definition of the term *significant unusual transaction* as *significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature*. This concept is in the ISAs but not as a defined term. The term *significant unusual transactions* has been used throughout GAAS instead of the phrases *nonroutine transactions* or *significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature.* This change was made to be more consistent with terminology used in the auditing standards of the PCAOB.

The ASB believes that these differences in wording do not create significant differences between the application of the ISAs and the application of GAAS.

Requirements in GAAS Not in the ISAs

Section 240 contains requirements that have been expanded from the requirements of ISA 240, or elevated from application material in ISA 240, as follows:

- The requirement in paragraph 15 of ISA 240 for the auditor to investigate inconsistent responses to auditor inquiries of management or those charged with governance has

[3] Paragraphs 14–15 of PCAOB Auditing Standard No. 3.

been expanded in paragraph .14 of section 240 to also include responses that are otherwise unsatisfactory (for example, vague or implausible responses).

- The requirement in paragraph 16 of ISA 240 that requires members of the engagement team to discuss the susceptibility of the entity's financial statements to material misstatements has been expanded in paragraph .15 of section 240 to include additional discussion items from application and other explanatory material in ISA 240 to requirements in section 240. These include a required brainstorming session focused very specifically on, among other things, internal and external fraud factors and the possibility of management override of controls. In addition, section 240 further clarifies the requirement for participation of key engagement team members and the engagement partner in the discussion and brainstorming sessions. Lastly, section 240 requires appropriate communication throughout the audit among the engagement team members. Several of these discussion items have been elevated from paragraphs A10–A11 of ISA 240.

- The requirement in paragraph 45 of ISA 240 to document the significant decisions reached during the discussion among the engagement team regarding fraud-related matters has been expanded in paragraph .43 of section 240 to also require documenting how and when the discussion occurred and the audit team members who participated.

- Procedures elevated from paragraph A19 of ISA 240 to requirements in paragraph .19 of section 240, related to making inquiries of internal audit as part of performing risk assessment procedures, include determining (*a*) whether internal audit has performed any procedures to identify or detect fraud during the year, and (*b*) whether management has satisfactorily responded to any findings resulting from these inquiries.

- The requirement in paragraph 35 of ISA 240 to evaluate whether the results of analytical procedures at or near the end of the reporting period indicate a previously unrecognized risk of material misstatement due to fraud has been expanded in paragraph .34 of section 240 to include the accumulated results of auditing procedures, including analytical procedures performed as substantive tests or when forming an overall conclusion. Section 240 also specifically requires performance of analytical procedures relating to revenue accounts through the end of the reporting period, in light of the generally higher risk of financial statement fraud involving revenue.

- The requirements in paragraph 33(a) of ISA 240 address designing and performing auditing procedures to test the appropriateness of journal entries. In addition to essential guidance about addressing the risk of possible management override of controls, included in paragraph .32*a* of section 240 are requirements to

  — obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, and, in accordance with paragraph. 27*b* of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, evaluate the design and determine whether the controls have been implemented.

— consider fraud risk factors, the nature and complexity of accounts, and entries processed outside the normal course of business, elevated from the application and other explanatory material contained in paragraph A44 of ISA 240 in order to emphasize the importance of these considerations.

— include identification and testing of specific journal entries regardless of controls.

- The requirement for the auditor to design and perform auditing procedures to review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud, in paragraph 33(b) of ISA 240, has been expanded in paragraph .32*b* of section 240 to include those estimates that are based on highly sensitive assumptions.

In addition, the following requirements in section 240 were expanded from the requirements of ISA 240 to be consistent with requirements in PCAOB AS 2410, *Related Parties*,[4] that the ASB believes will enhance audit quality for audits of financial statements of nonissuers.

- The requirement in paragraphs 18–20 of ISA 240 relating to required inquires has been expanded. Paragraph .17 of section 240 has been expanded to require inquiries of management about the existence, and if so, the nature, terms, and business purpose of, and involvement of related parties in, any significant unusual transactions. Similarly, the requirements in paragraphs .19 and .21 of section 240 have been expanded to include inquiry about whether the entity entered into any significant unusual transactions.

- The requirement in paragraph 33(c) of ISA 240 for the evaluation of significant transactions that are outside the normal course of business (that is, significant unusual transactions) has been expanded to include the following procedures:

  — Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction

  — Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures

  — Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

[4]All AS sections can be found in AICPA *PCAOB Standards and Related Rules*.

ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, Compared to Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Differences in Wording

Changes to the wording of section 250 include:

- In paragraphs .10*a* and .13, changing the phrase "compliance with the provisions of those laws and regulations generally recognized to have a direct and material effect on the determination of material amounts and disclosures in the financial statements" to the phrase "material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on their determination." This change was made to address the ASB's concerns that the requirement in ISA 250 (Revised) expanded the auditor's responsibility to encompass all aspects of those laws and regulations described in paragraph .06*a* of section 250, as opposed to focusing on the amounts and disclosures included in the financial statements. The ASB has discussed this issue with the IAASB, and the wording in section 250 reflects the intent of ISA 250 (Revised). The IAASB made subsequent changes to the application material in ISA 250 (Revised) to make this clear.
- In paragraphs .10*b* and .14, changing "to help identify" to "that may identify." The ASB believes that the wording of section 250 better conveys the intent of ISA 250 (Revised).
- In paragraph .18, adding the phrase "(at a level above those involved with the suspected noncompliance, if possible)."

Such changes have been made to make section 250 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 250 (Revised) and the application of section 250.

Placement of Certain Requirements Within GAAS

Paragraph 17 of ISA 250 (Revised) requires the auditor to request management and, when appropriate, those charged with governance to provide written representations regarding identified or suspected instances of noncompliance with relevant laws and regulations. The ASB believes this requirement is more appropriately placed in section 580, *Written Representations*. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 260 (Revised), *Communication with Those Charged with Governance*, Compared to Section 260, *The Auditor's Communication With Those Charged With Governance*

Differences in Wording

Changes to the wording of section 260 from ISA 260 (Revised) include

- in paragraph .12, requiring that the auditor communicate with those charged with governance "the auditor's views about qualitative aspects of the entity's significant accounting practices" compared with the requirement in paragraph 16 of ISA 260 (Revised) that the auditor communicate with those charged with governance "the auditor's views about significant qualitative aspects of the entity's accounting practices." The ASB believes that the wording of section 260 better conveys the intent of ISA 260 (Revised).
- in paragraph .16, changing the wording in ISA 260 (Revised) from "Written communications need not include all matters that arose during the course of the audit" to "This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved."

Such changes have been made to make section 260 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 260 (Revised) and the application of section 260.

Requirements in the ISAs Not in GAAS

Paragraphs 17 and 20 of ISA 260 (Revised) require the auditor to communicate certain matters regarding independence in the case of listed entities. These requirements are not applicable to the audits of nonissuers in the United States and, therefore, are not included in section 260.

Requirements in GAAS Not in the ISAs

Paragraph .12*a* of section 260 requires the auditor, when applicable, to determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates and about the basis for the auditor's conclusions regarding the reasonableness of those estimates. Additional matters required by paragraphs .12–.13 of section 260 for the auditor to communicate to those charged with governance, that are not required by ISA 260 (Revised), are

- significant unusual transactions.
- matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and

relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.

The fact that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit. Paragraph .14*a* and *c* of section 260 require, when not all of those charged with governance are involved in managing the entity, the auditor to communicate (*a*) material, corrected misstatements that were brought to the attention of management as a result of audit procedures, and (*b*) the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred. Paragraph .12*c* of section 260 requires the auditor to communicate disagreements with management, if any. ISA 260 (Revised) does not require communication of these matters. The ASB believes that it is important for these matters to be communicated to those charged with governance of non issuers in the United States.

Paragraph .17 of section 260 requires that if, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, the auditor should communicate any omitted or inadequately described matters to those charged with governance, and paragraph .21 includes a related documentation requirement. Paragraph .18 of section 260 requires the auditor, when communicating matters in accordance with section 260 in writing, to indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management and is not intended to be, and should not be, used by anyone other than these specified parties. ISA 260 (Revised) does not require this indication, nor does it prohibit it. The ASB believes that this communication meets the criteria for a by-product report under section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.

Placement of Certain Requirements Within GAAS

Consistent with requirements in paragraphs 12–13 of ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph .13 of section 260 contains a requirement for the auditor to communicate certain matters regarding uncorrected misstatements. The ASB believes that this communication with those charged with governance is more appropriately placed in section 260.

ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, Compared to Section 265, *Communicating Internal Control Related Matters Identified in an Audit*

Differences in Wording

Section 265 includes and defines the term *material weakness*, whereas ISA 265 does not.

The definitions of *material weakness*, *deficiency in internal control*, and *significant deficiency in internal control* have been modified to align with the definitions of these terms used in the standards of the PCAOB. The ASB believes that consistency between its standards and those of the PCAOB in the use and definition of these terms is essential in the United States due to legal and regulatory requirements, including those pertaining to the evaluation of the effectiveness of an entity's internal control over financial reporting.

Requirements in GAAS Not in the ISAs

Section 265 requires the auditor to evaluate each deficiency to determine, on the basis of the audit work performed, whether, individually or in combination, the deficiencies constitute significant deficiencies or material weaknesses. ISA 265 does not explicitly refer to the auditor's evaluation of each deficiency in making this determination. The ASB believes that the requirement in section 265 is consistent with the intent of ISA 265.

Section 265 requires the auditor to communicate significant deficiencies and material weaknesses to management and those charged with governance. Because ISA 265 does not include or define the term *material weakness*, ISA 265 does not contain a requirement to separately identify or communicate material weaknesses.

Section 265 includes an additional requirement for the auditor to consider, if the auditor determines that a deficiency, or a combination of deficiencies, in internal control is not a material weakness, whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion (paragraph .10).

Section 265 explicitly requires the auditor to document the communication of other deficiencies in internal control that are communicated orally to management (paragraph .12*b*).

Paragraphs 9–10 of ISA 265 require the auditor to communicate to those charged with governance and management on a timely basis. Paragraph .13 of section 265 requires the communication to be made no later than 60 days following the report release date. ISA 265 recognizes in paragraph A13 that the written communication of significant deficiencies forms part of the final audit file and is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis. ISA 230 states that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

In addition to the required elements of the written communication identified in paragraph 11 of ISA 265, paragraph .14 of section 265 requires that the following additional items/elements be included in the written communication:

- The definition of *material weakness* and, when relevant, the definition of *significant deficiency*
- An explanation that the auditor is not expressing an opinion on the effectiveness of internal control

- An explanation that the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies
- A statement restricting the use of the communication to management, those charged with governance, others within the organization, and any governmental authority to which the auditor is required to report

Paragraph .15 of section 265 includes reporting requirements when the auditor issues a written communication stating that no material weaknesses were identified during the audit of the financial statements. Paragraph .16 of section 265 prohibits the issuance of a written communication stating that no significant deficiencies were identified during the audit. ISA 265 does not address the issuance of communications indicating no material weaknesses or no significant deficiencies.

ISA 300, *Planning an Audit of Financial Statements*, Compared to Section 300, *Planning an Audit*

Requirements in GAAS Not in the ISAs

Paragraph .12 of section 300 contains requirements regarding the auditor's obligations for determining the extent of involvement of professionals possessing specialized skills. ISA 300 does not contain these requirements. The ASB believes these requirements, and the related application material, are necessary for the auditor's consideration of the need for specialized skills and knowledge in the audit.

ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, Compared to Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

Differences in Wording

Definitions

The definition of *inherent risk factors* has been enhanced for understandability to include "[d]epending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk." The definition of *relevant assertions* has been enhanced for understandability by including "[a] risk of material misstatement exists when (*a*) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (*b*) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude)." The additional language is found in the application material of section 200.

Control Environment, the Entity's Risk Assessment Process, the Entity's Process to Monitor the System of Internal Control, and the Information System and Communication Components

Paragraphs .21*b*, .22*b*, .24*c*, and .25*c* of section 315 include language to clarify that the evaluations required by these paragraphs are based on the auditor's required understanding of the respective components. Such language was used in lieu of presenting the requirements in a table format similar to paragraphs 21–26 of ISA 315 (Revised 2019). In addition, .25*c* of section 315 was clarified to indicate that the auditor considers the nature and complexity of the entity consistent with the evaluations required by paragraphs .21*b*, .22*b*, and .24*c*.

In understanding, as part of the entity's risk assessment process, the entity's process for identifying business risks relevant to financial reporting objectives, paragraph .22*a*(i) of section 315 was enhanced to clarify that such understanding includes the potential for fraud, which is consistent with inquiries related to management's assessment of the risk that the financial statements may be materially misstated due to fraud required by paragraph .17*a* of section 240 and paragraph 17(a) of ISA 240.

Assessing Control Risk

Paragraph 34 of ISA 315 (Revised 2019) states that if the auditor plans to test the operating effectiveness of controls, the auditor shall assess control risk. Paragraph .38 of section 315 provides further clarification that, for identified risks of material misstatement at the assertion level, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan. Paragraph 34 of ISA 315 (Revised 2019) further states that if the auditor does not plan to test the operating effectiveness of controls, the auditor's assessment of control risk shall be such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. To be consistent with the wording of the auditing standards of the PCAOB, paragraph .38 of section 315 requires the auditor to assess control risk at the "maximum level" if the auditor does not plan to test the operating effectiveness of controls, such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. Paragraph A71 of ISA 540 (Revised) indicates, as an example, that if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls.

The ASB believes these changes do not create differences between the application of ISA 315 (Revised 2019) and the application of section 315.

Differences Between Requirements

As part of obtaining an understanding the control activities component, paragraph 26(a)(ii) of ISA 315 (Revised 2019) requires the auditor to understand controls over journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions or adjustments. Paragraph .27*b* of section 315 requires the auditor to understand controls over journal entries and other adjustments as required by paragraph .32*a* of section 240. ISA 240 does not include a requirement equivalent to the requirement in paragraph .32*a* of section 240, as described in the analysis of ISA 240 herein.

ISA 320, *Materiality in Planning and Performing an Audit*, Compared to Section 320, *Materiality in Planning and Performing an Audit*

Differences in Wording

Paragraphs .02, .04, and .10 use different words to describe the concept of materiality, in order to be consistent with the description of materiality used by the U.S. judicial system, the auditing standards of PCAOB, the SEC, and FASB. The ASB believes that such consistency in the United States is in the public interest.

The ASB believes that these differences do not create differences between the application of ISA 320 and the application of section 320.

ISA 330, *The Auditor's Responses to Assessed Risks*, Compared to Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

Requirements in GAAS Not in the ISAs

Paragraph .20 of section 330 includes a requirement to confirm accounts receivable unless certain conditions exist. This requirement is not in the ISAs. The ASB believes it is appropriate to include this requirement.

Differences Between Requirements

To be consistent with the wording of the comparable requirements in the comparable auditing standard issued by the PCAOB, the requirement in paragraph .07 of section 330 has been modified with the words "relevant" and "material," and the requirement in paragraph .10 of section 330 has been expanded to specifically include addressing, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively. The ASB believes these differences do not create differences between the application of ISA 330 and the application of section 330.

Paragraph 18 of ISA 330 requires the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material class of transactions, account balance, and disclosure. To be consistent with the comparable requirement in PCAOB AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .18 of section 330 specifies that the auditor should perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure, regardless of the assessed level of control risk. However, consistent with the comparable requirement in ISA 315 (Revised 2019), for material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account balances, or disclosures, paragraph .40 of section 315 requires the auditor to evaluate whether the auditor's determination remains appropriate.

Placement of Certain Requirements Within GAAS

Paragraph .25 of section 330 includes a requirement for the auditor addressing the means of selecting items for testing. This requirement is in the ISAs in ISA 500, *Audit Evidence*. The ASB believes this requirement is more appropriately placed in section 330. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, Compared to Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*

Differences in Wording

The definitions of *Report on a description of a service organization's system and the suitability of the design of controls (type 1 report)* and *Report on a description of a service organization's system and the suitability of the design and operating effectiveness of controls* (*type 2 report*), in paragraph .08 of section 402, indicate that management's written assertion is an element of these reports. This is consistent with the definitions of these terms in International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*. The definitions of these terms in paragraph 8 of ISA 402 do not include management's written assertion as an element of the reports. The ASB believes that the definitions are consistent with the intent of ISA 402 and that the modifications do not create differences between the application of ISA 402 and the application of section 402.

Paragraphs 12, 14, and 17 of ISA 402 contain requirements that relate to the auditor's understanding of controls at the service organization. The wording in paragraphs .12, .14, and .17 of section 402 were revised to more clearly refer to the identified controls at the service organization that address risks of material misstatement at the assertion level in accordance with paragraphs .27 and .29*b* of section 315. The ASB believes that such changes do not create differences between the application of ISA 402 and the application of section 402.

ISA 450, *Evaluation of Misstatements Identified during the Audit*, Compared to Section 450, *Evaluation of Misstatements Identified During the Audit*

Placement of Certain Requirements Within GAAS

Paragraphs 12–13 of ISA 450 require the auditor to communicate certain matters regarding uncorrected misstatements to those charged with governance. The ASB believes that the requirements for this communication are more appropriately placed in section 260.

Paragraph 14 of ISA 450 requires the auditor to request written representations from management and, where appropriate, those charged with governance regarding uncorrected misstatements. The ASB believes this requirement is more appropriately placed in section 580.

The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 500, *Audit Evidence*, Compared to Section 500, *Audit Evidence*

Placement of Certain Requirements Within GAAS

Paragraph 8 of ISA 500 includes a requirement addressing auditor's responsibilities when the information to be used as audit evidence has been prepared using the work of a management's expert. The ASB believes this requirement is more appropriately placed in section 501, *Audit Evidence — Specific Considerations for Selected Items*. Paragraph 10 of ISA 500 includes a requirement for the auditor addressing the means of selecting items for testing. The ASB believes this requirement is more appropriately placed in section 330. The placement of these requirements does not create a difference between the ISAs as a whole and GAAS as a whole.

Requirements in GAAS Not in the ISAs

Paragraph .07*b* of section 500 explicitly requires the auditor, when evaluating information to be used as audit evidence, to take into account whether such information corroborates or contradicts assertions in the financial statements. The ASB believes that this requirement assists the auditor in applying professional skepticism.

Differences Between Requirements

The objective of section 500 differs from the objective of ISA 500 in that it is more broadly focused on considering the attributes of information to be used as audit evidence in assessing whether sufficient appropriate audit evidence has been obtained. The requirements in section 500 have been reworded to be consistent with this change in focus. The ASB believes that these differences do not result in the need for additional procedures when performing an audit in accordance with the ISAs as well as with GAAS.

ISA 501, *Audit Evidence — Specific Considerations for Selected Items*, Compared to Section 501, *Audit Evidence — Specific Considerations for Selected Items*

Requirements in GAAS Not in the ISAs

Section 501 contains specific requirements relating to auditing investments in securities when valuations are based on investee financial results that are not in ISA 501. The ASB concluded that it was appropriate to include these specific requirements.

Certain requirements in section 501 are based on the premise that the applicable financial reporting framework complies with FASB *Accounting Standards Codification* 450, *Contingencies*. In addition, the audit inquiry letters required under section 501 have been subjected to the provisions of the 1975 agreement between the AICPA and the American Bar Association (ABA treaty). Consequently, section 501 contains specific requirements relating to litigation, claims and assessments that are not contained in ISA 501. The ASB decided to include such content in section 501 because it is particular to the U.S. environment and relevant in practice.

Placement of Certain Requirements Within GAAS

Paragraph 12 of ISA 501 requires the auditor to request written representations from management and, where appropriate, those charged with governance regarding litigation and claims. The ASB believes this requirement is more appropriately placed in section 580. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 505, *External Confirmations*, Compared to Section 505, *External Confirmations*

Differences in Language

The definition of *external confirmation* has been expanded to include an example of a medium through which a response may be obtained. The example — direct access by the auditor to information held by a third party — addresses a situation that is increasingly common. The ASB believes that the inclusion of this concept clarifies the definition and is consistent with the intent of the definition in ISA 505.

ISA 510, *Initial Audit Engagements — Opening Balances*, Compared to Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*

Requirements in GAAS Not in the ISAs

Paragraph .07 of section 510 states that the auditor, when the prior period financial statements were audited by a predecessor auditor, should request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and to respond fully to inquiries by the auditor. Other requirements related to reviewing the predecessor auditor's audit documentation do not differ between ISA 510 and section 510.

Paragraph .13 of section 510 requires the auditor to respond when management refuses to inform the predecessor auditor that the prior period financial statements may need revision or if the auditor is not satisfied with the resolution of the matter. The ASB believes it is important to address this situation.

Paragraph .14 of section 510 states that the auditor should not make reference to the report or work of the predecessor auditor as the basis, in part, for the successor auditor's own opinion. The ASB believes this requirement is necessary in the United States to clearly distinguish this situation from the circumstances in section 600A, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, in which the auditor determines to make reference to the audit of a component auditor in the auditor's report on the group financial statements.

Differences Between Requirements

Paragraph 6(c) of ISA 510 requires the auditor to perform one or more of three identified procedures, in addition to the procedures required in paragraph 6(a–b) of ISA 510, to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. Two of the three procedures are (*a*) reviewing the predecessor auditor's audit documentation to obtain evidence regarding opening balances, and (*b*) evaluating whether audit procedures performed in the current audit provide evidence relevant to the opening balances. The ASB does not believe that either of these procedures, on its own, provides sufficient evidence regarding opening balances, and accordingly, the ASB has redrafted paragraph .08*c* of section 510 to require the auditor to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances and also to perform one or both of the other procedures identified in paragraph .08*c*(i–ii) of section 510.

ISA 520, *Analytical Procedures*, Compared to Section 520, *Analytical Procedures*

Differences in Wording

The ASB has made various changes to the wording throughout section 520 in comparison with ISA 520. The changes to section 520 include the following:

- In paragraph .05*c*, adding the parenthetical "(taking into account whether substantive analytical procedures are to be performed alone or in combination with tests of details)" to clarify that the auditor can use as audit evidence a substantive analytical procedure that is less precise than performance materiality when such analytical procedure is combined with other substantive audit procedures.
- In paragraph .05*d*, adding "compare the recorded amounts, or ratios developed from recorded amounts, with the expectations." The ASB is of the understanding that such procedure is presumed in ISA 520.

Such changes have been made to make section 520 easier to read and apply. The ASB believes that the changes made do not create differences between the application of ISA 520 and the application of section 520.

Requirements in GAAS Not in the ISAs

Section 520 includes specific documentation requirements, in paragraph .08, which ISA 520 does not. The ASB believes that the requirements are appropriate and should be retained from SAS No. 56, *Analytical Procedures*.

ISA 530, *Audit Sampling*, Compared to Section 530, *Audit Sampling*

Differences in Wording

The definition of *audit sampling* in paragraph 5 of ISA 530 was revised in section 530 because the ASB believes that the ISA 530 wording defining audit sampling to require the auditor to select items such that "each item has a chance of selection" is too imprecise to be meaningful. The definition was revised to (*a*) focus on conclusions about the population, and (*b*) include the fundamental concept of representativeness. Paragraph .08 of section 530, which establishes a requirement with respect to the selection of items in a population, reflects the revised definition of *audit sampling*.

Requirements in the ISAs Not in GAAS

The requirement in paragraph 13 of ISA 530 that addresses the issue of anomalies is not included in section 530. The ASB expressed concerns about terms used in paragraph 13 of ISA 530, such as "in the extremely rare circumstances" and "a high degree of certainty." These terms are not used in GAAS and the ASB believes these terms would not be consistently interpreted in practice. The ASB also believes that the deletion from section 530 of the option to consider a misstatement an anomaly will enhance audit quality because misstatements identified by the auditor during audit sampling will be treated in the same manner as any other misstatement identified by the auditor and, thus, will prevent the misuse of anomalies.

Paragraph 14 of ISA 530 requires, for tests of details, the projection of misstatements found in a sample to the population. The ASB believes that projection of misstatements is also relevant to tests of controls and tests of compliance, and accordingly, has broadened the requirement in paragraph .14 of section 530 to project the results of audit sampling to also include tests of controls and tests of compliance.

Other

The appendixes of ISA 530 were not included in section 530 because the guidance contained therein is covered by AICPA Audit Guide *Audit Sampling*.

ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, Compared to Section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Placement of Certain Requirements Within GAAS

Paragraph 37 of ISA 540 (Revised) requires the auditor to request written representations from management and, when appropriate, those charged with governance about whether the methods, significant assumptions, and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement, or disclosure that is in accordance with the applicable financial reporting framework. The auditor is also required to consider the need to obtain representations about specific accounting estimates, including in relation to the methods, assumptions, or data used. The ASB believes this requirement is more appropriately placed in section 580. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 550, *Related Parties*, Compared to Section 550, *Related Parties*

Requirements in GAAS Not in the ISAs

ISA 550 distinguishes between fair presentation and compliance frameworks and between financial reporting frameworks that contain related party requirements and financial reporting frameworks that have minimal or no related party requirements. However, the ASB believes that fair presentation frameworks are the only financial reporting frameworks used in the United States. Further, to achieve fair presentation, disclosures related to related parties, such as those required by generally accepted accounting principles (GAAP), are necessary and, accordingly, section 550 defines *related party* as "a party as defined in GAAP." Thus, section 550 does not refer to applicable financial reporting frameworks; the applicability, objectives, and requirements of section 550 are the same regardless of the applicable financial reporting framework.

In addition, the following requirements in section 550 were expanded from the requirements of ISA 550 to minimize differences with requirements in PCAOB AS 2410, *Related Parties*, that the ASB believes will enhance audit quality for audits of financial statements of nonissuers.

- Paragraphs .14–.15 of section 550 expand the inquiries required by ISA 550 to include inquiries of management and others within the entity regarding (1) the business purpose of entering into a transaction with a related party versus an unrelated party; (2) whether the entity modified or terminated any transactions with related parties during the period; and (3) related party transactions that were not authorized or approved in accordance with the entity’s policies or procedures or for which exceptions were granted, and the reasons for granting those exceptions.
- Paragraph .16 of section 550 requires that, unless all of those charged with governance are involved in managing the entity, the auditor should inquire of those charged with governance (or the audit committee or, at least, its chair) regarding
  - — their understanding of the entity's relationships and transactions with related parties that are significant to the entity and
  - — whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.
- Paragraph .17 of section 550 expands the documents the auditor is required to inspect for indications of the existence of unidentified related party transactions to

include summaries of actions of recent meetings for which minutes have not yet been prepared.

- Paragraph .22 of section 550 requires the auditor to evaluate whether the entity has properly identified its related party relationships and transactions, including the performance of procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity.
- Paragraph .23 of section 550 requires the auditor to perform procedures that address the related risks of material misstatement on balances with affiliated entities as of concurrent dates.

Paragraph 23 of ISA 550 requires the auditor to perform specified procedures for identified significant related party transactions outside the entity's normal course of business. Paragraph .26 of section 550 requires the auditor to perform the same specified procedures for identified related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk.

Placement of Certain Requirements Within GAAS

Paragraph 26 of ISA 550 requires the auditor to request that management and, when appropriate, those charged with governance, provide written representations regarding related party transactions. The ASB believes this requirement is more appropriately placed in section 580. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 560, *Subsequent Events*, Compared to Section 560, *Subsequent Events and Subsequently Discovered Facts*

Differences in Wording

Paragraph 5 of ISA 560 defines *subsequent events* to include both events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report. Section 560 includes separate definitions for *subsequent events* and *subsequently discovered facts* to clearly distinguish the auditor's responsibilities for each. The definition of *subsequently discovered facts* was also expanded to use language that is consistent with language in the objectives and requirements of ISA 560 (paragraphs 4(b) and 14) but that is not specifically included in the definition in ISA 560.

Paragraph 5 of ISA 560 further defines *the date the financial statements are issued*, which is the date the auditor's report and audited financial statements are made available to third parties. This term was deleted from section 560 because the applicable financial reporting framework may define the financial statement issuance date. In addition, because GAAS define the report release date, the ASB believes the definition could cause confusion with respect to the release versus the issuance of the auditor's report. Although the definition was deleted, the requirements in section 560 were modified to use terms that are well understood in the United States and to be consistent with the intent of the requirements in ISA 560.

Paragraph 12 of ISA 560 permits the auditor to dual date the auditor's report when law or regulation does not prohibit management from restricting the revision of the financial statements to the effects of the subsequent event or events causing that revision and those responsible for approving the financial statements are not prohibited from restricting their approval to that revision. In the United States, no such prohibition by law or regulation exists. Accordingly, paragraph .13 of section 560 omits the reference to law or regulation.

Because the date of the auditor's report and the report release date are within the auditor's control, the requirements in paragraphs .12–.18 of section 560 were restructured with reference to the report release date in lieu of reference to the date that the financial statements were issued. Similar changes were made to the related application and other explanatory material.

Paragraph 15(b) of ISA 560 requires the auditor to review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements, together with the auditor's report thereon, is informed of the situation. Paragraphs .16*b* and .17*b* of section 560 require the auditor to determine whether management's steps are timely and appropriate. The ASB believes this is consistent with the intent of the requirements of ISA 560.

The ASB believes these changes do not create differences between the application of ISA 560 and the application of section 560.

Requirements in the ISAs Not in GAAS

Certain requirements in ISA 560 also require the auditor to provide the auditor's report or a new or revised auditor's report. These references were eliminated from the requirements in section 560 because the ASB believes that it is not necessary to require the auditor to provide the auditor's report.

Paragraph 12(b) of ISA 560, which is an optional form of dual dating, was not included in section 560 because it is uncommon in the United States to provide a new or revised auditor's report that includes a statement in an emphasis-of-matter paragraph that conveys that the auditor's procedures on subsequent events are restricted solely to the revision of the financial statements, as described in the relevant note to the financial statements.

Requirements in GAAS Not in the ISAs

Section 560 includes an additional objective in paragraph .06, requirements in paragraphs .19–.20, and application and other explanatory material in paragraphs .A27–.A30 related to a predecessor auditor's responsibilities when reissuing the auditor's report on previously issued financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period. ISA 560 does not include such requirements.

Paragraph 9 of ISA 560 requires the auditor to request that management and, when appropriate, those charged with governance provide written representations regarding subsequent events. This requirement is included in paragraph .18 of section 580. However, if the financial statements are subsequently revised, paragraph .13*a–b* of section 560 include additional requirements for the auditor to request management to provide certain representations when the auditor either dates the auditor's report as of a later date or includes an additional date limited to the revision (that is, dual dates the auditor's report for that revision). These representations are not included in ISA 560.

Placement of Certain Requirements Within GAAS

Paragraph 5 of ISA 560 defines *the date of approval of the financial statements*. This definition was deleted from the definitions of section 560 because the ASB did not believe it was necessary to its application and because the term is described in paragraph .A57 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

Paragraphs 11(b)(ii) and 15(c)(i) of ISA 560 require that the new auditor's report not be dated earlier than the date of approval of the revised financial statements. This requirement is not included in section 560 because the requirements for dating the report are addressed in section 700.

As noted in the preceding section, the requirement in paragraph 9 of ISA 560 regarding written representations has been moved to section 580.

Paragraph 16 of ISA 560 requires the auditor to include in the new or revised auditor's report an emphasis-of-matter paragraph or other-matter paragraph in situations when the financial statements are revised after the financial statements have been issued. Paragraph 16 of ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, includes a similar requirement related to comparative financial statements and the auditor's opinion on prior period financial statements, when reporting on prior period financial statements in connection with the current period's audit, differs from the opinion previously expressed. Requirements have been placed in paragraph .16*c* of section 560 and paragraphs .13–.14 of section 708, *Consistency of Financial Statements*, that when considered together, achieve the intent of the requirements in paragraph 16 of ISA 560 and paragraph 16 of ISA 710.

The ASB believes such placements do not create differences between the ISAs as a whole and GAAS as a whole.

ISA 570 (Revised), *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, Compared to Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

Differences in Language

Section 570 is intended to be applicable to audits of financial statements prepared under various financial accounting frameworks and accordingly was written to be framework-neutral. In discussing certain concepts, reference to accounting terms is necessary. To better explain and illustrate those concepts, section 570 uses terminology that is more commonly used in the Unites States, such as terminology from the FASB standards and GASB statements, for example "substantial doubt."

Requirements in GAAS Not in the ISAs

Section 570 includes a definition of reasonable period of time that includes the period of time required by the applicable financial reporting section, in paragraph .11, and also includes application material in paragraph .A6 with examples of the periods contained in various financial reporting frameworks. ISA 570 (Revised) does not include this definition or the related application material.

Paragraph .10 of section 570 contains an objective of the auditor to evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern. The ASB believes that the inclusion of this objective is important to address disclosures, particularly for accounting frameworks that contain explicit disclosure requirements. ISA 570 (Revised) does not include this objective.

Paragraph .17 contains a requirement to obtain sufficient appropriate evidence when management's plans include financial support by third parties or the entity's owner-manager and such support is necessary in supporting management's assertions about the entity's ability to continue as a going concern. The ASB believes that this requirement is important to address this situation.

Paragraph .18 of section 570 contains a requirement of the auditor to request written representations from management about management's plans to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern and the completeness of the financial statement disclosures that management is aware that are relevant to the entity's ability to continue as a going concern. Paragraphs .29–.30 include requirements that address comparative presentations and eliminating a going-concern emphasis-of-matter paragraph from a reissued report. Paragraph .32 of section 570 contains a requirement of the auditor to document specific matters related to the auditor's evaluation and conclusions about conditions or events that are identified, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern before consideration of management's plans. The ASB believes it is important to retain these requirements from SAS No. 126, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

ISA 580, *Written Representations*, Compared to Section 580, *Written Representations*

Differences in Wording

Paragraph 8 of ISA 580 describes management's responsibility in the case of a fair presentation framework. The ASB believes that all the acceptable financial reporting frameworks in the United States are fair presentation frameworks, and, thus, the requirements of section 580 reflect this perspective.

Requirements in the ISAs Not in GAAS

Paragraph 15 of ISA 580 contains a requirement related to situations in which law or regulation requires management to make written public statements about its responsibilities. The ASB believes that these situations are not applicable to nonissuers in the United States and, accordingly, such requirements are not included in section 580.

Differences Between Requirements

Paragraph 14 of ISA 580 requires that the date of the written representations be as near as practicable to, but not after, the date of the auditor's report on the financial statements. Paragraph .20 of section 580 requires that the date of the written representations be as of the date of the auditor's report. Paragraph .A27 of section 580 states that, occasionally, circumstances may prevent management from signing the representation letter and returning it to the auditor on the date of the auditor's report. In these circumstances, the auditor may accept management's oral confirmation, on or before the date of the representations, that management has reviewed the final representation letter and will sign the representation letter without exception as providing sufficient appropriate audit evidence for the auditor to date the report. However, possession of the signed management representation letter prior to releasing the auditor's report is necessary because paragraph .21 of section 580 requires that the representations be in the form of a written letter from management.

Paragraph .17 of section 580 requires the auditor to request management to provide written representations that it has disclosed to the auditor the identify of all the entity's related parties. The corresponding requirement in paragraph 26 of ISA 550, *Related Parties*, does not include the word *all* with regard to the entity's related parties.

Placement of Certain Requirements Within GAAS

The following ISAs contain requirements for requesting written representations:

- Paragraph 40 of ISA 240
- Paragraph 17 of ISA 250
- Paragraph 14 of ISA 450
- Paragraph 12 of ISA 501
- Paragraph 37 of ISA 540 (Revised)
- Paragraph 26 of ISA 550
- Paragraph 9 of ISA 560

Such requirements have been included in paragraphs .12–.19 of section 580. The ASB believes these requirements, which relate to representations that would be obtained for every audit engagement, are more appropriately placed in section 580. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, Compared to , *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

Differences in Wording

All the requirements in ISA 600 are addressed to either the group engagement partner or the group engagement team. In section 600, requirements that, in the circumstances, may be appropriately fulfilled by the firm are addressed to the auditor of the group financial statements. These requirements, in paragraphs .16 and .29, relate to engagement acceptance and modification of the auditor's opinion on the group financial statements. The ASB believes that this does not create a substantive difference between the requirements of ISA 600 and the requirements of section 600A.

Requirements in the ISAs Not in GAAS

ISA 600 does not permit the auditor's report on the group financial statements to make reference to a component auditor unless required by law or regulation to include such reference. Section 600A permits the auditor, in the auditor's report on the group financial statements, to make reference to the audit of a component auditor.

The ASB believes that the ability to make reference to the report of another auditor is appropriate in the United States for several reasons. No compelling practice issues suggest a need to change an approach that has always been permitted by GAAS in the United States. The size, complexity, and diversity of some audits, in particular the audit of the federal government in which withdrawing from the engagement or disclaiming an opinion are not viable options, make eliminating the option to make reference to a component auditor problematic. In addition, the ASB believes that there will be considerable practical problems with access issues, particularly with equity investments, under the approach in ISA 600. The ASB believes that there is no difference in the effectiveness of the audit in either approach when the audits are conducted in accordance with GAAS. Accordingly, section 600A contains requirements and application and other explanatory material relating to making reference to the report of another auditor that are not in ISA 600, which results in substantive differences in the wording of the objectives, requirements, and application material between ISA 600 and section 600A. A group audit conducted in accordance with GAAS when the group engagement partner determines to make reference to the audit performed by a component auditor would not comply with the ISAs. As such, in an audit conducted under both GAAS and the ISAs, the auditor of the group financial statements would need to assume responsibility for the work of all component auditors and, therefore, plan the audit accordingly to comply with both sets of standards.

When no reference is made to a component auditor in the auditor's report on the group financial statements, no substantive differences exist between the requirements of ISA 600 and the requirements of section 600A.

Differences Between Requirements

Paragraph .41*c* of section 600A expands the requirement in paragraph 40(e) of ISA 600 to clarify that the communication of a list of related parties prepared by group management and any other related parties of which the group engagement team is aware includes the nature of the entity's relationships and transaction with those related parties. This clarification is not in ISA 600.

ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, Compared to Section 610, *Using the Work of Internal Auditors*

Requirements in the ISAs Not in GAAS

Using Internal Auditors to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance

Section 610 does not include paragraph 26 of ISA 610 (Revised 2013) because obtaining direct assistance from internal auditors is not prohibited in the United States.

Paragraph 27 of ISA 610 (Revised 2013) contains a requirement that the external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity. This requirement is not included in section 610 because the ASB believes it is implicit in the overall requirement to evaluate the internal auditor's objectivity.

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance

GAAS do not include paragraph 30 of ISA 610 (Revised 2013) in section 610 because the paragraph precludes the external auditor's use of internal auditors to provide direct assistance in specified circumstances. The ASB believes that the requirements in paragraphs 30*a* and 30*b* were not necessary in the context of audits of nonissuers in the United States. These requirements are partly redundant with the requirement in paragraph .27 of section 610 regarding the need for the auditor to consider the amount of judgment involved in determining the nature and extent of work to assign to internal auditors and the nature, timing, and extent of the review thereof. Additional material was added to paragraph .A42 section 610 to further emphasize that as materiality of the financial statement amounts increases, and either the assessed risks of material misstatement or the amount of judgment involved increases, the need for the external auditor to perform procedures directly increases. The ASB further concluded that the requirements in paragraphs 30*c* and 30*d* were not necessary because an appropriate assessment of the objectivity of the internal auditors in accordance with section 610 would result in a conclusion that it would not be appropriate for internal auditors' work to be used in the situations addressed by those paragraphs.

Using Internal Auditors to Provide Direct Assistance

Paragraph 33*b* of ISA 610 (Revised 2013) requires that, prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity. Given the established practice and historical experience of using internal auditors to provide direct assistance, the ASB did not believe that it was necessary to include this requirement for the audits of nonissuers in the United States. However, the ASB added application material to indicate that the auditor may determine it necessary to instruct the internal auditors to keep specific matters confidential and, in some situations, may determine it to be necessary to request written acknowledgement from the internal auditors of having understood such instruction (paragraph .A41 of section 610).

Differences Between Requirements

Using Internal Auditors to Provide Direct Assistance

Paragraph 31 of ISA 610 (Revised 2013) establishes a requirement that, in communicating with those charged with governance, an overview of the planned scope and timing of the audit in accordance with ISA 260, *Communication with Those Charged with Governance*, the external auditor should communicate the nature and extent of the planned use of internal auditors to provide direct assistance *so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement*. The ASB decided to revise this paragraph to improve the clarity of the requirement and eliminate the requirement to explicitly obtain a mutual understanding with those charged with governance that the proposed nature and extent of the use of internal auditors to provide direct assistance is not excessive because it was not considered necessary in the context of audits of nonissuers in the United States. The ASB believes that the external auditor's communication required by paragraph .28 of section 610 provides those charged with governance the opportunity to voice any concerns.

Paragraph 34*a* of ISA 610 (Revised 2013) requires the external auditor to direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220. It further states that the "nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this ISA." The ASB omitted the phrase *recognize that the internal auditors are not independent of the entity* from the comparable requirement in paragraph .31*a* because the ASB did not believe there was any incremental effect of the phrase on the nature, timing, and extent of the external auditor's required actions. The ASB also believes that the fact that internal auditors are not independent of the entity is already implicit in, and encompassed by, the external auditor's evaluation of the factors in paragraph .27 of section 610.

In paragraph .31*c* of section 610, the ASB revised paragraph 34*b* of ISA 610 (Revised 2013) to express the requirement in terms more commonly understood in the United States and that are more consistent with the terminology in section 610.

Requirements in GAAS Not in the ISAs

Using Internal Auditors to Provide Direct Assistance

The ASB added paragraph 31*b*, which represents a requirement to instruct internal auditors to bring accounting and auditing issues to the attention of the external auditors. The ASB believes that it is important to retain this requirement from SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*.

The ASB believes these differences do not create a difference between the application of ISA 610 (Revised 2013) and the application of section 610.

ISA 620, *Using the Work of an Auditor's Expert,* Compared to Section 620, *Using the Work of an Auditor's Specialist*

Differences in Wording

Paragraph 12(b) of ISA 620 requires the auditor to evaluate the significant assumptions and methods of the auditor's specialist. The ASB expanded the wording of this requirement to more clearly articulate the auditor's responsibility in this regard. The ASB believes this does not create a difference between the application of ISA 620 and the application of section 620.

Requirements in the ISAs Not in GAAS

Paragraph 14 of ISA 620 contains a conditional requirement regarding the auditor's reference to the auditor's specialist in the auditor's report when such reference is required by law or regulation. Because such reference is not required by law or regulation in the United States, such requirement is not included in section 620.

ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, Compared to Section 700, *Forming an Opinion and Reporting on Financial Statements*

Differences in Wording

Paragraph 13(d) of ISA 700 (Revised) requires the auditor to evaluate, among other things, whether, in view of the requirements of the applicable financial reporting framework, the information that should have been included has been included, and whether such information is appropriately classified, aggregated or disaggregated, and characterized. Paragraph .15*d* of section 700 uses the term "presented" instead of "characterized" in the otherwise identical requirement. The ASB believes replacing "characterized" with "presented" addresses the presentation in paragraph 13(d)(ii) of ISA 700 (Revised) and therefore this does not create a difference between the application of ISA 700 (Revised) and section 700.

Paragraph 34(a) of ISA 700 (Revised) requires the auditor's report to describe management's responsibility for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Paragraph .32*a* of section 700 requires the auditor's report to describe management's responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements. The ASB believes section 700 better conveys management's responsibility in the United States.

Paragraph 38(b) of ISA 700 (Revised) requires the auditor's report to state that reasonable assurance is a high level of assurance, but not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Paragraph .35*b* of section 700 states that reasonable assurance is a high level of assurance but not absolute assurance and therefore is not a guarantee. The ASB believes this does not create a difference in the application of ISAs and the application of GAAS.

Paragraph 39(b)(iv) of ISA 700 requires the auditor's report to describe an audit by stating what the auditor's responsibilities are in ISA 570 (Revised). As noted previously in the ISA 570 (Revised) section of this appendix, section 570 is intended to be applicable to audits of financial statements prepared under various financial accounting frameworks and accordingly was written to be framework-neutral. In discussing certain concepts, reference to accounting terms is necessary. To better explain and illustrate those concepts, section 570 uses terminology that is more commonly used in the Unites States, such as terminology from the FASB standards and GASB statements, for example "substantial doubt." Accordingly, the language in the auditor's report aligns with the requirements in section 570.

Requirements in the ISAs Not in GAAS

Compliance Framework

Paragraphs 7(b), 19, and 26 of ISA 700 (Revised) discuss financial statements prepared in accordance with a compliance framework. GAAS do not include any references to compliance frameworks because the ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks. Accordingly, section 700 is written in the context of a complete set of general-purpose financial statements prepared in accordance with a fair presentation framework.

Definitions

Paragraph 7(b) of ISA 700 (Revised) defines *fair presentation framework*. Section 700 does not include this definition because fair presentation framework is already defined in section 200. As noted previously, section 700 does not include any references to compliance frameworks; therefore, there is no need to emphasize the differences between a fair presentation framework and a compliance framework in section 700.

Use of True and Fair View

Paragraphs 25(b) and 36 of ISA 700 (Revised) indicate that the description in the auditor's report can refer either to the preparation and fair presentation of the financial statements or the preparation of financial statements that give a true and fair view. GAAS do not include any references to "true and fair view" because such wording has not historically been used in the United States; GAAS continues to require the use of "present fairly, in all material respects" in the auditor's opinion.

Requirements for Listed Entities

Paragraphs 30, 40(b), and 46 of ISA 700 (Revised) contain requirements relating to audits of listed entities. Such requirements are not applicable to audits of nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Opinion Section

Paragraph 24(d) of ISA 700 (Revised) requires the opinion section of the auditor's report to refer to the summary of significant accounting policies. Section 700 does not include this requirement because the ASB believes the notes to the financial statements are an integral part of the financial statements, and specific notes need not be identified in the opinion section. The ASB believes this does not create a difference between the application of ISA 700 (Revised) and the application of section 700.

Responsibilities of Management for the Financial Statements

Paragraph 33 of ISA 700 (Revised) requires the report to use a term that is appropriate in the context of the legal framework in the particular jurisdiction and need not refer specifically to "management" when the auditor's report discusses management's responsibilities. Section 700 does not include this requirement because the ASB believes this paragraph relates to jurisdictions in which the structure of the boards and corporate law are different than in the United States. In the United States, the ASB believes reference to management is sufficient. The ASB believes this does not create a difference between the application of ISA 700 (Revised) and the application of section 700.

Paragraph 35 of ISA 700 (Revised) requires the auditor's report to identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described in paragraph 34 of ISA 700 (Revised). Section 700 does not include this requirement because the ASB believes that distinction may cause confusion in a nonissuer environment. The ASB believes this does not create a difference in the application of the ISA 700 (Revised) and the application of section 700.

Auditor's Responsibilities for the Audit of the Financial Statements

Paragraph 38(c)(ii) of ISA 700 (Revised) requires the auditor's report to state that misstatements can arise from fraud or error and either (i) describe that they are considered material, if individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or (ii) provide a definition or description of materiality in accordance with the applicable financial reporting framework. Section 700 requires the auditor to include the description in (i) and does not include the option in (ii) to provide a definition or description of materiality in accordance with the applicable financial reporting framework. The ASB believes this will create more consistency in reporting and was mindful to minimize differences between the PCAOB form of auditor's report and section 700. The ASB believes this does not create a difference in the application of ISA 700 (Revised) and the application of section 700.

Paragraph 39(c) of ISA 700 (Revised) requires the auditor's report to further describe the auditor's responsibilities in a group audit engagement. Section 700 does not include this requirement because GAAS permits for the auditor to have divided responsibility in group audit situations and therefore the reporting language in section 600A provides transparency as to the responsibilities of the auditor in such situations. The ASB believes this does not create a difference in the application of the ISA 700 (Revised) and the application of section 700.

Information Presented in the Financial Statements

Paragraph 54 of ISA 700 (Revised) contains requirements when supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, ISA 700 (Revised) requires the auditor to ask management to change how the unaudited supplementary information is presented and if management refuses to do so, the auditor should explain in the auditor's report that such supplementary information has not been audited. In the United States, section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, addresses the auditor's responsibility when engaged to report on supplementary information. At the present time, no ISAs exist that correspond to section 725. GAAS do not include the requirement for the auditor to ask management to change how the unaudited supplementary information is presented when the supplementary information is not clearly differentiated from the audited financial statements.

Requirements in GAAS Not in the ISAs

Responsibilities of Management for the Financial Statements

Paragraph .33 of section 700 adds a requirement that the description about management's responsibilities for the financial statements in the auditor's report should not be referenced to a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report.

ISA 700 (Revised) does not contain this requirement, which the ASB believes is appropriate for inclusion in GAAS.

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

Paragraph .46 of section 700 adds a requirement on how to report when conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB. ISA 700 (Revised) does not contain this requirement which is specific to the United States.

Differences Between Requirements

Basis for Opinion — Auditor Independence

Paragraph 28(c) of ISA 700 (Revised) requires the "Basis for Opinion" section to include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement should identify the jurisdiction of origin of the relevant ethical requirements or refer to the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*. Paragraph .28*c* of section 700 requires the "Basis for Opinion" section to include a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit and does not require identification of the jurisdiction of origin of the relevant ethical requirements. The ASB believes section 700 better conveys the auditor's independence and ethical responsibilities in the Unites States while minimizing differences between the PCAOB form of the auditor's report and section 700. The ASB believes having different statements about the auditor's responsibilities for independence in the GAAS report and in the PCAOB report would cause confusion in the United States and that such difference between the two reports is not necessary.

Key Audit Matters

Paragraph 31 of ISA 700 (Revised) requires that when the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor should do so in accordance with ISA 701. Paragraph .30 of section 700 requires that when the auditor is engaged to communicate key audit matters the auditor should do so in accordance with section 701. The ASB is not aware of law or regulation in the United States that requires communication of key audit matters for nonissuers and believes this does not create a difference in the application of the ISAs and the application of GAAS.

Auditor's Responsibilities for the Audit of the Financial Statements

Paragraph 39(b)(v) requires the report to describe an audit by stating that the auditor's responsibilities are to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. Paragraph .36*d* of section 700 requires the auditor to include in the auditor's report the auditor's responsibility to evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements. The ASB believes this does not create a difference in the application of the ISAs and the application of GAAS.

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

Paragraph .46 of section 700 adds a requirement on how to report when conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB. ISA 700 (Revised) does not contain this requirement which is specific to the United States.

Placement of Certain Requirements Within GAAS

Comparative Financial Statements

Section 700 addresses comparative financial statements and comparative information, which are not addressed in ISA 700 (Revised), but are addressed in ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements* See the section "ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, Compared to Section 700, *Forming an Opinion and Reporting on Financial Statements*," following for a comparison of the requirements of section 700 and the requirements of ISA 710. ISA 710 addresses reporting in other jurisdictions that are not common to the United States, including corresponding figures that are not covered by the auditor's report. For simplicity, the ASB decided to include those requirements and application material that apply in the United States in section 700 rather than have a separate AU-C section.

Key Audit Matters

Paragraph 40(c) of ISA 700 (Revised) requires the report to describe key audit matters in the auditor's responsibilities section of the auditor's report. For simplicity, and because GAAS does not require the communication of KAM in the auditor's report, section 701 requires a description of key audit matters, when the auditor is engaged to include key audit matters in the auditor's report, to be placed in a separate key audit matters section.

Auditor's Report Prescribed by Law or Regulation

Paragraph 50 of ISA 700 (Revised) discusses the auditor's report prescribed by law or regulation. Section 700 does not contain this section because it does not pertain to general purpose financial statements in the United States. Auditor's reports prescribed by law or regulation are addressed in section 800.

The ASB believes that the placement of these requirements does not create differences between the application of the ISAs as a whole and the application of GAAS as a whole.

ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, Compared to Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Differences in Wording

Going Concern

Paragraph 15 of ISA 701 describes the interaction between descriptions of key audit matters and other elements required to be included in the auditor's report. Section 700 contains the same section; however, section 700 aligns with the terminology used in section 570.

Requirements in the ISAs Not in GAAS

Required Communication of Key Audit Matters

ISA 701 addresses the auditor's responsibilities to communicate key audit matters in the auditor's report and applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. Section 701 does not require the communication of key audit matters. This is not inconsistent with ISA 701 because ISA 701 only requires listed entities to communicate key audit matters. In the United States, audits of listed entities are within the jurisdiction of the PCAOB and therefore GAAS does not contain a similar requirement. The ASB believes this does not create a difference in the application of the ISAs and the application GAAS.

ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, Compared to Section 705, *Modifications to the Opinion in the Independent Auditor's Report*

Requirements in the ISAs Not in GAAS

Compliance Framework

GAAS do not include any references to compliance frameworks because the ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks. Accordingly, the reference to compliance frameworks in paragraphs 17(b) and 18(b) of ISA 705 (Revised) are included in paragraphs .18–.19 of section 705.

Use of True and Fair View

GAAS do not include any references to "true and fair view" because such wording has not historically been used in the United States; GAAS continue to require the use of "present fairly, in all material respects" in the auditor's opinion. Accordingly, the references to "true and fair view" in paragraphs 17(a)–18(a) of ISA 705 (Revised) are not included in paragraphs .18–.19 of section 705. The ASB believes this does not result in a difference in the application of the ISAs and the application of GAAS.

Multiple Uncertainties

Paragraph 10 of ISA 705 (Revised) requires the auditor to disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. Section 705 does not include this requirement because the ASB believes that a disclaimer of opinion is appropriate only when the auditor is not able to obtain sufficient appropriate audit evidence.

Differences Between Requirements

Management-Imposed Scope Limitation

Paragraph 13(b)(i) of ISA 705 (Revised) requires the auditor to withdraw from the audit when the auditor is unable to obtain sufficient appropriate audit evidence, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation. Paragraph .13*b* of section 705 changes this requirement so that the auditor should either disclaim an opinion on the financial statements or withdraw from the engagement, when practical, under such circumstances. The ASB believes that in the United States, the auditor should not be required to withdraw from an engagement but, rather, should be able to decide whether to withdraw or disclaim an opinion on the financial statements based upon the pervasiveness of the effects on the financial statements. The ASB believes this does not create differences between the application of ISA 705 (Revised) and the application of section 705.

Description of Auditor's Responsibilities When the Auditor Disclaims an Opinion

Paragraph 28(c) of ISA 705 (Revised) requires the auditor, when the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, to amend the description of the auditor's responsibilities section of the auditor's report to include the statement about auditor independence and other ethical responsibilities required by paragraph 28(c) of ISA 700 (Revised). Paragraph .29*c* of section 705 requires a statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit, required by paragraph .28*c* of section 700 or paragraph .67*c* or .107*c* of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. The ASB believes that the requirement in section 700 better conveys the auditor's independence and ethical responsibilities in the Unites States while being mindful to minimize differences between the PCAOB form of the auditor's report and section 700. The wording in section 705 aligns with section 700 requirements.

Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements

Paragraph 29 of ISA 705 (Revised) precludes the auditor from including a Key Audit Matters section in accordance with ISA 701 when the auditor disclaims an opinion. Paragraph .30 of section 705 precludes the auditor from including a Key Audit Matters section when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements. The ASB believes this incremental requirement to be appropriate for inclusion in GAAS.

ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, Compared to Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

Differences Between Requirements

Emphasis-of-Matter Paragraphs in the Auditor's Report

Paragraph 9(a) of ISA 706 (Revised) requires the auditor, when the auditor includes an emphasis-of-matter paragraph in the auditor's report, to use an appropriate heading that includes the term "Emphasis of Matter." In the same situation, paragraph .09*a* of section 706 requires the auditor to use an appropriate heading and only requires the use of the term "Emphasis of Matter" to be included in the heading when key audit matters are communicated in the auditor's report. Because key audit matters are not required under GAAS, the ASB believes it is only necessary to require the use of the term "emphasis-of-matter" when the term is needed to help differentiate between an emphasis-of-matter section and a key audit matters section.

ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, Compared to Section 700, *Forming an Opinion and Reporting on Financial Statements*

Differences in Wording

The definitions of *comparative information* and *comparative financial statements* in paragraph 6(a) and (c) of ISA 710 have been revised to reflect U.S. conventions.

Requirements in the ISAs Not in GAAS

ISA 710 addresses reporting in other jurisdictions that are not common in the United States, including corresponding figures that are not covered by the auditor's report. GAAS do not include any references to corresponding figures because these are not common in the United States.

Requirements in GAAS Not in the ISAs

Comparative Information

Paragraph .48 of section 700 requires that 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.

Paragraph .50 of section 700 contains a requirement that if comparative information is presented, and the entity requests the auditor to express an opinion on all periods presented, the auditor should consider whether the information included for the prior periods contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework.

Audit Procedures

Paragraph .51 of section 700 contains a requirement that the audit procedures in paragraphs .51–.53 of section 700 should apply regardless of whether comparative financial statements or comparative information is presented for the prior period.

Prior Period Financial Statements

Paragraph .56 of section 700 includes requirements on what to disclose in an emphasis-of-matter paragraph or other-matter paragraph when reporting on prior period financial statements in connection with the current period's audit, and the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed.

Paragraph .57 of section 700 adds "and the predecessor auditor's report on the prior period's financial statements is not reissued" to the requirement. This was added to clarify that if the report was reissued, section 560 would apply. In addition, a requirement was added to include in the other-matter paragraph the nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any.

Prior Period Financial Statements Not Audited

Paragraphs .59–.60 of section 700 include requirements on how to report when prior period financial statements were not audited, reviewed, or compiled, to better clarify what is covered in section 700 related to comparative financial statements and comparative information.

ISA 710 does not contain these requirements. The ASB believes these requirements and related application material are appropriate for inclusion in GAAS.

Placement of Certain Requirements Within GAAS

ISA 710 addresses reporting in other jurisdictions that are not common to the United States, including corresponding figures that are not covered by the auditor's report. For simplicity, the ASB decided to include certain requirements and application material for comparative financial statements and comparative information in section 700 rather than having a separate AU-C section. The ASB believes that the requirements in section 700 related to comparative financial statements and comparative information are consistent with the intent of ISA 710 and that the placement of these requirements does not create differences between the application of the ISAs as a whole and the application of GAAS as a whole.

ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*, Compared to Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

Differences in Wording

The ASB has made various changes to the wording throughout section 720, in comparison with ISA 720. The changes to section 720 include the following:

- Adding paragraph .02, which clarifies that section 720 “may be applied, and adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention."
- In paragraph .05, deleting the phrase "either by law, regulation or custom" from the definition of *other information* to avoid confusion with required supplementary information.
- Adding paragraph .09, which clarifies that the section does not apply to supplementary information addressed by section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, or required supplementary information addressed by section 730, *Required Supplementary Information*. There are no equivalent ISAs to sections 725 and 730.
- In paragraph .12, adding the phrase "other-matter" to clarify the report modification.
- In paragraph .17, adding the wording "by the entity in determining whether such matter is a material misstatement of fact" to clarify that the advice is received by the entity.

Such changes have been made to make section 720 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 720 (Revised) and the application of section 720.

Requirements in GAAS not in the ISAs

Paragraph .13*a* of section 720 includes a requirement that the auditor obtain management's written acknowledgment regarding which document or documents comprise the annual report and the entity's planned manner and timing of the issuance of such documents.

Paragraph .14 of section 720 includes a requirement for the auditor to take appropriate action if the auditor becomes aware that the entity did not provide the auditor with the final version of documents determined in accordance with paragraph .13*a* to be part of the annual report prior to the issuance of those documents to third parties.

The ASB believes that these incremental requirements are appropriate for inclusion in GAAS.

Requirements in the ISAs not in GAAS

Section 720 does not include reporting requirements when the auditor is required by law or regulation of a specific jurisdiction to refer to the other information in the auditor's report using a specific layout or wording. The ASB believes that such requirements are not necessary in the U.S. environment.

Differences Between Requirements

Paragraph .21 of section 720 provides the option for the auditor to withhold the auditor's report if the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance. The ASB believes it important to retain this option from the previous SAS.

Paragraph .24 of section 720 requires that the auditor report on the other information only when the auditor has obtained all of the other information at the date of the auditor's report. ISA 720 (Revised) requires that the auditor report on the other information when the auditor "has obtained some or all of the other information" at the date of the auditor's report. The ASB believes that, because a framework for annual reports rarely exists in the nonissuer environment in the United States, a requirement to report when "some" of the other information is obtained at the date of the auditor's report could confuse users of the auditor's report and therefore is not in the public interest.

ISA 800 (Revised), *Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, Compared to Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

Differences in Wording

Definitions

Paragraph 6 of ISA 800 defines a *special purpose framework* as a financial reporting framework (a fair presentation framework or a compliance framework) designed to meet the financial information needs of specific users. Section 800 defines a special purpose framework as one of the following bases of accounting: cash, tax, regulatory, contractual, or other basis of accounting, all of which are fair presentation frameworks in the United States. An other basis of accounting is a basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

Considerations When Planning and Performing the Audit

Paragraph 9 of ISA 800 requires the auditor to determine whether application of the ISAs requires special consideration in the circumstances of the engagement. However, paragraph .12 of section 800 requires the auditor to adapt all AU-C sections relevant to the audit as necessary in the circumstances of the engagement. The ASB believes that the requirement in section 800 is consistent with the intent of ISA 800 and that such changes do not create differences between the application of ISA 800 and the application of section 800.

Requirements in GAAS Not in the ISAs

Considerations When Accepting the Engagement

Paragraph .11 of section 800 includes a requirement for the auditor, when accepting the engagement, to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures, including specified disclosures, that are appropriate for the special purpose framework used to prepare the entity's financial statements.

Description of the Applicable Financial Reporting Framework

Paragraph .15 of section 800 includes a requirement for the auditor to evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP.

Fair Presentation

If the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, paragraph .18 of section

800 includes a requirement for the auditor to evaluate whether the financial statements include informative disclosures similar to those required by GAAP. Paragraph .18 of section 800 also requires the auditor to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the financial statements to achieve fair presentation.

Restricting the Use of the Auditor's Report

Paragraph .21 of section 800 requires the auditor's report to include an other-matter paragraph that restricts the use of the auditor's report when the special purpose financial statements are prepared in accordance with a contractual basis of accounting, a regulatory basis of accounting, or an other basis of accounting when required pursuant to paragraphs .06*a–b* of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, except for the circumstances described in paragraph .22 of section 800. In accordance with paragraph .22 of section 800, the other-matter paragraph is not required when the special purpose financial statements are prepared in accordance with a regulatory basis of accounting and the special purpose financial statements together with the auditor's report are intended for general use. In this circumstance, the auditor is required to express an opinion on whether the financial statements are prepared in accordance with GAAP and, in a separate paragraph, an opinion on whether the financial statements are prepared in accordance with the special purpose framework.

Auditor's Report Prescribed by Law or Regulation

Paragraph .22 of section 800 identifies the required minimum elements to be included in the auditor's report when the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report. Paragraph .24 requires the auditor to reword the prescribed form of report or attach an appropriately worded separate report if the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make.

These requirements are not included in ISA 800.

Differences Between Requirements

Auditor's Report

Paragraph 13 of ISA 800 requires the auditor's report to describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information. Section 800 does not require this description when the special purpose financial statements are prepared in accordance with the cash or tax basis of accounting.

Alerting Readers That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework

Paragraph 14 of ISA 800 requires the auditor's report to include an emphasis-of-matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. Paragraph .20*c* of section 800 requires the emphasis-of-matter paragraph to state that the special purpose framework is a basis of accounting other than GAAP and only requires the auditor's report to state that the "financial statements may not be suitable for another purpose" when a description of the purpose for which the financial statements are prepared or a reference to a note in the special purpose financial statements that contains that information is required by paragraph .19*a*. In accordance with paragraph .22 of section 800, the emphasis-of-matter paragraph is not required when the special purpose financial statements are prepared in accordance with a regulatory basis of accounting and the special purpose financial statements together with the auditor's report are intended for general use.

Placement of Certain Requirements Within GAAS

Paragraph .14 of section 800 indicates that the following requirements in section 570 apply irrespective of whether the going concern basis of accounting is relevant to the preparation of the financial statements:

- To conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- When such substantial doubt exists, to evaluate the adequacy of the financial statement disclosures

The ASB believes this is essential guidance for section 800 that does not create a difference in the application of the requirements of the ISAs and the requirements of GAAS.

ISA 805 (Revised), *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, Compared to Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*

Requirements in the ISAs Not in GAAS

Form of Opinion

Paragraph 9 of ISA 805 requires the auditor to consider whether the expected form of opinion is appropriate in the circumstances. This requirement was not included in section 805 because the circumstances to which it relates are not applicable in the United States.

Requirements in GAAS Not in the ISAs

Materiality

Paragraph .14 of section 805 requires the auditor to determine materiality for the single financial statement being reported on, and in the case of an audit of one or more specific elements of a financial statement, materiality for each individual element reported on.

Considerations When Accepting the Engagement and Planning and Performing the Audit

Paragraph .10 of section 805 requires the auditor to obtain an understanding of (*a*) the purpose for which the single financial statement or specific element of a financial statement is prepared, (*b*) the intended users, and (*c*) the steps taken by management to determine that the application of the financial reporting framework is acceptable in the circumstances. The ASB believes this requirement is necessary in determining the acceptability of the financial reporting framework that is applicable to a single financial statement or a specific element of a financial statement.

Paragraph .09 of section 805 requires the auditor to determine whether the auditor will be able to perform procedures on interrelated items as a consideration when accepting the engagement. Paragraph .13 of section 805 includes a requirement for the auditor to perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element that is, or is based upon, the entity's stockholders' equity or net income (or the equivalents thereto), paragraph .13 of section 805 further requires the auditor to perform procedures necessary to obtain sufficient appropriate audit evidence about financial position, or financial position and results of operations, respectively, because of the interrelationship between the element and the balance sheet accounts and the income statement accounts.

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With GAAP

When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, paragraph .24 of section 805 requires the auditor to include an emphasis-of-matter paragraph in the auditor's report, alerting users as to the purpose of the presentation and that the presentation is incomplete. ISA 805 does not address reporting on incomplete presentations that are otherwise in accordance with the applicable financial reporting framework.

ISA 805 does not contain these requirements.

Differences Between Requirements

Reporting on the Entity's Complete Set of Financial Statements and a Single Financial Statement or a Specific Element of Those Financial Statements

Paragraph 12 of ISA 805 requires the auditor to express a separate opinion for each engagement when undertaking an engagement to report on a single financial statement or a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements. Paragraph .16 of section 805 requires that the separate opinions be in separate auditor's reports and that the report on a specific element include certain information about the auditor's report on the entity's complete set of financial statements.

Paragraph .20 of section 805 address the case of an audit of a specific element of a financial statement when the opinion in the auditor's report on an entity's complete set of financial statements is modified and the modification of the auditor's opinion is relevant to the audit of the specific element. In such cases, the auditor is required to express either an adverse opinion or disclaim an opinion on the specific element, depending on the reasons for the modification of the auditor's opinion on the complete set of financial statements. ISA 805 does not specifically require an adverse opinion or disclaimer of opinion in such circumstances.

Paragraph 16 of ISA 805 addresses situations when 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, but in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element. In addition to the matters in ISA 805, paragraph .21 of section 805 precludes such reporting when the specific element is, or is based upon, the entity's stockholders' equity or net income (or the equivalent thereto).

ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*, Compared to Section 810, *Engagements to Report on Summary Financial Statements*

Differences in Wording

Paragraph .05 of section 810 includes more specificity than is in paragraph 3 of ISA 810, including an objective to perform the procedures necessary as the basis for the auditor's opinion on the summary financial statements, and a description of the opinion. The ASB believes that these changes do not create differences between the intent of ISA 810 and the intent of section 810.

Paragraph 6(b)(ii) of ISA 810 requires that management make the audited financial statements available to the intended users of the summary financial statements without undue difficulty. Section 810 requires in paragraph .09*b*(ii) that management make the audited financial statements readily available. This is not a substantive difference between ISA 810 and the section 810. The terminology in section 810 aligns with section 930, *Interim Financial Information*.

If the summary financial statements contain comparatives that were reported on by another auditor, both ISA 810 and section 810 require the auditor's report on the summary financial statements to contain certain matters. Such matters are included directly in paragraph .23 of section 810 and incorporated in paragraph 22 of ISA 810 by reference to ISA 710.

Requirements in the ISAs Not in GAAS

Paragraphs 6–7 of ISA 810 include requirements pertaining to (*a*) criteria established by law or regulation, (*b*) situations in which law or regulation does not require the audited financial statements to be made available, and (*c*) accepting the engagement when required by law or regulation to do so. These requirements were not included in section 810 because they are not applicable to the United States.

Paragraph 9 of ISA 810 permits the use of two different phrases when opining on summary financial statements. Paragraph .14 of section 810 only includes one of these phrases, which is consistent with practice.

Paragraphs 10–11 of ISA 810 address situations when regulation prescribes the wording of the opinion on the summary financial statements in terms that are different from those described in ISA 810. These requirements were not included in section 810 as they are not applicable in the United States.

Paragraph 15 of ISA 810 requires the auditor to evaluate the appropriateness of using a different addressee, if the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements. Section 810 does not include this requirement because the ASB believes having different addressees is never appropriate.

Differences Between Requirements

Paragraph 19 of ISA 810 addresses the reporting elements when the auditor expresses an unmodified opinion on the summary financial statements and the auditor's report on the audited financial statements contains certain specified elements, including a statement that describes an uncorrected material misstatement of other information. In ISA 810, the requirement in this paragraph only applies when the auditor expresses an unmodified opinion on the summary financial statements. The comparable requirement in paragraph .18 of section 810 applies when the auditor expresses either an unmodified opinion or an adverse opinion on the summary financial statements and does not address situations in which the auditor's report on the audited financial statements includes a statement that describes an uncorrected material misstatement of other information.

Section 810, in paragraph .21, eliminated the reference to the restriction on distribution of the auditor's report in paragraph 20 of ISA 810. In the United States, use of an auditor's report is restricted, not its distribution. An auditor is not responsible for controlling management's distribution of restricted-use reports.

[Revised, October 2023, to reflect the updated title of the IESBA Code of Ethics for Professional Accountants.]

AU-C Appendix C

[*Reserved*.]

AU-C Appendix D

AICPA Audit and Accounting Guides and Statements of Position

Audit and Accounting Guides

Airlines

Analytical Procedures

Assessing and Responding to Audit Risk in a Financial Statement Audit

Assets Acquired to Be Used in Research and Development Activities

Audit Sampling

Brokers and Dealers in Securities

Construction Contractors

Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies

Employee Benefit Plans

Entities With Oil and Gas Producing Activities

Gaming

Government Auditing Standards *and Single Audits*

Health Care Entities

Investment Companies

Life and Health Insurance Entities

Not-for-Profit Entities

Property and Liability Insurance Entities

Revenue Recognition

Special Considerations in Auditing Financial Instruments

State and Local Governments

Testing Goodwill for Impairment

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Statements of Position—Auditing

Auditing Property/Casualty Insurance Entities' Statutory Financial Statements—Applying Certain Requirements of the NAIC Annual Statement Instructions	*10/92*
Auditing the Statement of Social Insurance	*11/04*

AU-C Appendix E

Schedule of Changes in Statements on Auditing Standards[a]

Section	Paragraph	Changes	Date of Change
200	.03	Added by SAS No. 123.	October 2011
200	.07	Amended by SAS No. 138.	December 2019
200	.08	Amended by SAS No. 145.	December 2023
200	.14	Amended by SAS No. 134.	May 2019
200	.14	Amended by SAS No. 142.	December 2022
200	.14	Amended by SAS No. 145.	December 2023
200	.15	Added by SAS No. 123.	October 2011
200	.15	Added by SAS No. 123.	October 2011
200	.19	Amended by SAS No. 142.	December 2022
200	.A15	Added by SAS No. 145.	December 2023
200	.A18	Added by SAS No. 123.	October 2011
200	.A26–.A27	Added by SAS No. 142.	December 2022
200	.A44–.A45	Amended by SAS No. 145.	December 2023
200	.A46	Amended by SAS No. 143; subsequently amended by SAS No. 145.	December 2023
200	.A47	Added by SAS No. 145.	December 2023
200	.A50	Amended by SAS No. 136.	July 2019
200	.A67	Amended by SAS No. 145.	December 2023
200	.A72	Added by SAS No. 145.	December 2023
200	.A73	Amended by SAS No. 145.	December 2023
200	.A74	Added by SAS No. 145.	December 2023
200	.A76	Amended by SAS No. 142.	December 2022
200	.A77	Amended by SAS No. 128.	January 2015
210	.11	Amended by SAS No. 147.	June 2022
210	.12–.13	Added by SAS No. 147.	June 2022
210	.15	Added by SAS No. 147.	June 2022
210	.A16	Amended by SAS No. 145.	December 2022
210	.A30	Amended by SAS No. 147.	June 2022
210	.A31	Added by SAS No. 147.	June 2022
210	[.A32]	Deleted by SAS No. 147.	June 2022
210	.A33	Amended by SAS No. 147.	June 2022
210	.A34	Added by SAS No. 147.	June 2022
210	.A35	Amended by SAS No. 147.	June 2022

Section	Paragraph	Changes	Date of Change
220		Superseded by SAS No. 146.	June 2022
220	.A1	Amended by SAS No. 149.	March 2023
220	.A22–.A23	Added by SAS No. 149.	March 2023
220	.A26–.A27	Amended by SAS No. 149.	March 2023
220	.A55–.A56	Amended by SAS No. 149.	March 2023
220	.A62	Amended by SAS No. 149.	March 2023
220	[.A79]	Deleted by SAS No. 149.	March 2023
220	.A95	Amended by SAS No. 149.	March 2023
220	.A101	Amended by SAS No. 149.	March 2023
230	.06	Amended by SAS No. 142.	December 2022
230	.19	Added by SAS No. 123.	October 2011
230	.A9	Amended by SAS No. 143.	December 2023
230	.A12	Amended by SAS No. 134.	May 2019
230	.A12	Amended by SAS No. 143.	December 2023
230	.A20	Amended by SAS No. 145.	December 2023
230	.A22	Amended by SAS No. 128.	January 2015
230	.A30	Amended by SAS No. 134.	May 2019
230	.A30	Amended by SAS No. 137.	July 2019
230	.A30	Amended by SAS No. 143.	December 2023
240	.07	Amended by SAS No. 145.	December 2023
240	.11	Amended by SAS No. 135.	May 2019
240	.15	Amended by SAS No. 134.	May 2019
240	.16	Amended by SAS No. 145.	December 2023
240	.17	Amended by SAS No. 135.	May 2019
240	.19	Amended by SAS No. 128.	January 2015
240	.19	Amended by SAS No. 135.	May 2019
240	.20	Amended by SAS No. 145.	December 2023
240	.21	Amended by SAS No. 135.	May 2019
240	.27	Amended by SAS No. 145.	December 2023
240	.32	Amended by SAS No. 135.	May 2019
240	.32	Amended by SAS No. 145.	December 2023
240	.43	Amended by SAS No. 145.	December 2023
240	.A6	Amended by SAS No. 134.	May 2019
240	.A9	Amended by SAS No. 145.	December 2023
240	.A13	Amended by SAS No. 134.	May 2019
240	.A19	Amended by SAS No. 135.	May 2019
240	.A21–.A22	Amended by SAS No. 145.	December 2023
240	.A27	Amended by SAS No. 145.	December 2023

[a]This table lists changes resulting from Statements on Auditing Standards (SASs) issued subsequent to SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which was issued in October 2011.

Section	Paragraph	Changes	Date of Change
240	.A30	Amended by SAS No. 145.	December 2023
240	.A37	Amended by SAS No. 145.	December 2023
240	.A48–.A49	Amended by SAS No. 145.	December 2023
240	.A53	Amended by SAS No. 143.	December 2023
240	.A54	Amended by SAS No. 135.	May 2019
240	.A55	Added by SAS No. 135.	May 2019
240	.A62	Amended by SAS No. 136.	July 2019
240	.A72	Amended by SAS No. 135.	May 2019
240	.A75	Amended by SAS No. 128.	January 2015
240	.A76	Amended by SAS No. 135.	May 2019
240	.A76–.A77	Amended by SAS No. 145.	December 2023
260	.03	Amended by SAS No. 134.	May 2019
260	.11	Amended by SAS No. 134.	May 2019
260	.12	Amended by SAS No. 123.	October 2011
260	.12	Amended by SAS No. 134.	May 2019
260	.12	Amended by SAS No. 135.	May 2019
260	.13	Amended by SAS No. 135.	May 2019
260	.14	Amended by SAS No. 134.	May 2019
260	.17	Amended by SAS No. 125.	December 2011
260	.17	Added by SAS No. 135.	May 2019
260	.21	Amended by SAS No. 135.	May 2019
260	.A13	Amended by SAS No. 134.	May 2019
260	.A17	Added by SAS No. 134.	May 2019
260	.A20	Amended by SAS No. 128.	January 2015
260	.A20	Added by SAS No. 134.	May 2019
260	.A20	Amended by SAS No. 145.	December 2023
260	.A21–.A22	Amended by SAS No. 134.	May 2019
260	.A21	Amended by SAS No. 145.	December 2023
260	.A22	Amended by SAS No. 137.	July 2019
260	.A24	Amended by SAS No. 134.	May 2019
260	.A26	Added by SAS No. 134.	May 2019
260	.A27	Added by SAS No. 123.	October 2011
260	.A27	Amended by SAS No. 134.	May 2019
260	.A28	Added by SAS No. 134.	May 2019
260	.A27–.A29	Amended by SAS No. 143.	December 2023
260	.A30	Amended by SAS No. 134.	May 2019
260	.A30	Added by SAS No. 135.	May 2019
260	.A32–.A33	Added by SAS No. 134.	May 2019
260	.A34	Amended by SAS No. 134.	May 2019
260	.A35–.A36	Added by SAS No. 134.	May 2019
260	.A38	Amended by SAS No. 128.	January 2015

Section	Paragraph	Changes	Date of Change
260	.A40	Amended by SAS No. 134.	May 2019
260	.A45	Amended by SAS No. 128.	January 2015
260	.A48	Amended by SAS No. 134.	May 2019
260	.A50	Amended by SAS No. 134.	May 2019
260	.A57	Amended by SAS No. 134.	May 2019
260	.A56–.A57	Amended by SAS No. 143.	December 2023
260	.A58	Amended by SAS No. 137.	July 2019
265	.01–.02	Amended by SAS No. 145.	December 2023
265	.07	Amended by SAS No. 145.	December 2023
265	.14	Amended by SAS No. 125.	December 2011
265	.A1	Added by SAS No. 145.	December 2023
265	.A4	Amended by SAS No. 145.	December 2023
265	.A8	Amended by SAS No. 135.	May 2019
265	.A11	Amended by SAS No. 145.	December 2023
265	.A26	Amended by SAS No. 128.	January 2015
265	.A32	Amended by SAS No. 125.	December 2011
265	.A38–.A39	Amended by SAS No. 125.	December 2011
300	.A15–.A16	Added by SAS No. 134.	May 2019
300	.A25	Amended by SAS No. 128.	January 2015
300	.A26	Amended by SAS No. 145.	December 2023
300	.A27	Amended by SAS No. 134.	May 2019
315	.06	Amended by SAS No. 128.	January 2015
315	.19	Amended by SAS No. 134.	May 2019
315	.24	Amended by SAS No. 128.	January 2015
315	.27	Amended by SAS No. 134.	May 2019
315	.29	Amended by SAS No. 135.	May 2019
315	.A1	Amended by SAS No. 128.	January 2015
315	.A1	Amended by SAS No. 134.	May 2019
315	.A7	Added by SAS No. 128.	January 2015
315	.A8	Added by SAS No. 128.	January 2015
315	.A9	Added by SAS No. 128.	January 2015
315	.A10	Added by SAS No. 128.	January 2015
315	.A11	Added by SAS No. 128.	January 2015
315	.A12	Added by SAS No. 128.	January 2015
315	.A13	Added by SAS No. 128.	January 2015
315	.A19	Amended by SAS No. 134.	May 2019
315	.A20	Added by SAS No. 134.	May 2019
315	.A28	Amended by SAS No. 134.	May 2019
315	.A31–.A32	Amended by SAS No. 134.	May 2019
315	.A36	Amended by SAS No. 135.	May 2019
315	.A81	Added by SAS No. 128.	January 2015

Section	Paragraph	Changes	Date of Change
315	.A83	Amended by SAS No. 134.	May 2019
315	.A94–.A95	Added by SAS No. 134.	May 2019
315	.A99	Amended by SAS No. 134.	May 2019
315	.A106	Added by SAS No. 134.	May 2019
315	.A112	Added by SAS No. 128.	January 2015
315	.A113	Amended by SAS No. 128.	January 2015
315	.A114	Amended by SAS No. 128.	January 2015
315	.A115	Added by SAS No. 128.	January 2015
315	.A116	Added by SAS No. 128.	January 2015
315	.A117	Amended by SAS No. 128.	January 2015
315	.A118	Added by SAS No. 128.	January 2015
315	.A119	Added by SAS No. 128.	January 2015
315	.A120	Added by SAS No. 128.	January 2015
315	.A127	Amended by SAS No. 134.	May 2019
315	.A131–.A133	Amended by SAS No. 134.	May 2019
315	.A134	Added by SAS No. 134.	May 2019
315	.A139–.A140	Amended by SAS No. 134.	May 2019
315	.A141–.A143	Added by SAS No. 134.	May 2019
315	.A147	Added by SAS No. 134.	May 2019
315	.A148–.A149	Amended by SAS No. 135.	May 2019
315	.A153	Amended by SAS No. 135.	May 2019
315	.A167	Amended by SAS No. 134.	May 2019
315		Superseded by SAS No. 145.	October 2021
320	.02	Amended by SAS No. 138.	December 2019
320	.04	Amended by SAS No. 138.	December 2019
320	.06	Amended by SAS No. 134.	May 2019
320	.10	Amended by SAS No. 138.	December 2019
320	.A1	Added by SAS No. 134.	May 2019
320	.A12	Amended by SAS No. 138.	December 2019
320	.A13	Amended by SAS No. 134.	May 2019
330	.01	Amended by SAS No. 136.	July 2019
330	.06	Amended by SAS No. 142.	December 2022
330	.07–.08	Amended by SAS No. 145.	December 2023
330	.10	Amended by SAS No. 145.	December 2023
330	.13	Amended by SAS No. 145.	December 2023
330	.15–.18	Amended by SAS No. 145.	December 2023
330	.21	Amended by SAS No. 134.	May 2019
330	.26	Amended by SAS No. 134.	May 2019
330	.28	Amended by SAS No. 142.	December 2022
330	.29	Amended by SAS No. 145.	December 2023
330	.33	Amended by SAS No. 134.	May 2019

Section	Paragraph	Changes	Date of Change
330	.A1	Amended by SAS No. 145.	December 2023
330	.A4	Amended by SAS No. 145.	December 2023
330	.A7	Amended by SAS No. 145.	December 2023
330	.A10–.A11	Amended by SAS No. 145.	December 2023
330	.A14–.A15	Amended by SAS No. 134.	May 2019
330	.A19	Amended by SAS No. 145.	December 2023
330	.A21	Amended by SAS No. 145.	December 2023
330	.A25	Amended by SAS No. 145.	December 2023
330	.A29	Amended by SAS No. 145.	December 2023
330	.A32	Amended by SAS No. 145.	December 2023
330	.A33–.A34	Added by SAS No. 145.	December 2023
330	.A35	Amended by SAS No. 145.	December 2023
330	[.A36]	Deleted by SAS No. 145.	December 2023
330	.A37	Amended by SAS No. 145.	December 2023
330	.A40–.A41	Amended by SAS No. 145.	December 2023
330	.A43	Amended by SAS No. 145.	December 2023
330	.A47	Amended by SAS No. 145.	December 2023
330	.A48	Amended by SAS No. 142.	December 2022
330	.A50	Amended by SAS No. 145.	December 2023
330	.A51–.A52	Amended by SAS No. 142.	December 2022
330	.A51	Amended by SAS No. 145.	December 2023
330	.A57	Amended by SAS No. 134.	May 2019
330	.A58	Added by SAS No. 135.	May 2019
330	.A59	Amended by SAS No. 135.	May 2019
330	.A59	Amended by SAS No. 142.	December 2022
330	.A64	Amended by SAS No. 145.	December 2023
330	.A66	Amended by SAS No. 142.	December 2022
330	.A66	Amended by SAS No. 145.	December 2023
330	.A72	Amended by SAS No. 134.	May 2019
330	.A75	Added by SAS No. 134.	December 2022
330	.A76	Amended by SAS No. 145.	December 2023
330	.A77	Amended by SAS No. 142.	December 2022
330	.A79–.A80	Amended by SAS No. 145.	December 2023
402	.01	Amended by SAS No. 145.	December 2023
402	.03	Amended by SAS No. 145.	December 2023
402	.07	Amended by SAS No. 145.	December 2023
402	.10–.12	Amended by SAS No. 145.	December 2023
402	.14	Amended by SAS No. 145.	December 2023
402	.17	Amended by SAS No. 145.	December 2023
402	.A1	Amended by SAS No. 128.	January 2015
402	.A14	Amended by SAS No. 145.	December 2023

Section	Paragraph	Changes	Date of Change
402	.A19	Amended by SAS No. 145.	December 2023
402	.A24	Amended by SAS No. 145.	December 2023
402	.A31–.A32	Amended by SAS No. 145.	December 2023
402	.A35–.A36	Amended by SAS No. 145.	December 2023
402	.A41	Amended by SAS No. 145.	December 2023
450	.01	Amended by SAS No. 136.	July 2019
450	.04	Amended by SAS No. 134.	May 2019
450	.09	Amended by SAS No. 136.	July 2019
450	.A1–.A2	Amended by SAS No. 134.	May 2019
450	.A3–.A5	Added by SAS No. 134.	May 2019
450	.A6	Amended by SAS No. 134.	May 2019
450	.A9	Amended by SAS No. 134.	May 2019
450	.A15	Amended by SAS No. 136.	July 2019
450	.A22	Amended by SAS No. 134.	May 2019
450	.A23	Amended by SAS No. 138.	December 2019
450	.A23–.A24	Added by SAS No. 134.	May 2019
450	.A28	Amended by SAS No. 137.	July 2019
450	.A29	Amended by SAS No. 134.	May 2019
500	.A52	Amended by SAS No. 128.	January 2015
500		Superseded by SAS No. 142.	July 2020
500	.A67	Amended by SAS No. 145.	December 2023
501	.01	Amended by SAS No. 142.	July 2020
501	.01	Amended by SAS No. 143.	July 2020
501	.03	Amended by SAS No. 142.	July 2020
501	.03	Amended by SAS No. 144.	June 2021
501	.04	Added by SAS No. 142.	July 2020
501	.05	Amended by SAS No. 143.	July 2020
501	[.07–.11]	Deleted by SAS No. 143.	July 2020
501	.27	Added by SAS No. 142.	July 2020
501	.27	Amended by SAS No. 144.	June 2021
501	.A1	Added by SAS No. 143.	July 2020
501	.A2	Amended by SAS No. 143.	July 2020
501	[.A3]	Deleted by SAS No. 143.	July 2020
501	.A6–.A7	Amended by SAS No. 143.	July 2020
501	.A9	Amended by SAS No. 143.	July 2020
501	[.A12–.A20]	Deleted by SAS No. 143.	July 2020
501	.A24	Amended by SAS No. 145.	December 2023
501	.A29–.A31	Amended by SAS No. 144.	June 2021
501	.A53	Amended by SAS No. 136.	July 2019
501	.A65	Amended by SAS No. 136.	July 2019
501	.A69–.A70	Added by SAS No. 142.	July 2020

Section	Paragraph	Changes	Date of Change
501	.A71	Added by SAS No. 142.	July 2020
501	.A71	Amended by SAS No. 144.	June 2021
501	.A72	Added by SAS No. 142.	July 2020
501	.A72	Amended by SAS No. 144.	June 2021
501	.A73–.A78	Added by SAS No. 142.	July 2020
501	.A79	Added by SAS No. 142.	July 2020
501	.A79	Amended by SAS No. 144.	June 2021
501	.A80	Added by SAS No. 142.	July 2020
501	.A81	Added by SAS No. 142.	July 2020
501	.A81	Amended by SAS No. 144.	June 2021
501	.A82–.A83	Added by SAS No. 142.	July 2020
501	.A84	Amended by SAS No. 144.	June 2021
501	.A85–.A88	Added by SAS No. 144.	June 2021
505	.03	Amended by SAS No. 145.	December 2023
510	.01	Amended by SAS No. 136.	July 2019
510	.A5	Amended by SAS No. 135.	May 2019
510	.A15	Amended by SAS No. 136.	July 2019
510	.A18	Added by SAS No. 134.	May 2019
510	.A20	Amended by SAS No. 134.	May 2019
510	.A20	Amended by SAS No. 138.	December 2019
530	.02	Amended by SAS No. 142.	December 2022
530	.A10	Amended by SAS No. 145.	December 2023
540		Superseded by SAS No. 143.	July 2020
540	.04–.05	Amended by SAS No. 145.	December 2023
540	.07	Amended by SAS No. 145.	December 2023
540	.12	Amended by SAS No. 145.	December 2023
540	.15–.16	Amended by SAS No. 145.	December 2023
540	.18	Amended by SAS No. 145.	December 2023
540	.A8–.A10	Amended by SAS No. 145.	December 2023
540	.A19–.A21	Amended by SAS No. 145.	December 2023
540	.A24–.A25	Amended by SAS No. 145.	December 2023
540	.A29	Amended by SAS No. 145.	December 2023
540	.A35	Amended by SAS No. 145.	December 2023
540	.A39	Amended by SAS No. 145.	December 2023
540	.A44	Amended by SAS No. 145.	December 2023
540	.A50–.A54	Amended by SAS No. 145.	December 2023
540	.A64–.A71	Amended by SAS No. 145.	December 2023
540	.A79	Amended by SAS No. 145.	December2023
540	.A85	Amended by SAS No. 145.	December 2023
540	.A107	Amended by SAS No. 144.	June 2021
540	.A127–.A128	Amended by SAS No. 144.	June 2021

Section	Paragraph	Changes	Date of Change
540	.A154	Added by SAS No. 144.	June 2021
550	.01	Amended by SAS No. 135.	May 2019
550	.02	Amended by SAS No. 136.	July 2019
550	.14	Amended by SAS No. 135.	May 2019
550	.15	Amended by SAS No. 135.	May 2019
550	.16	Added by SAS No. 135.	May 2019
550	.17	Amended by SAS No. 135.	May 2019
550	.18	Amended by SAS No. 135.	May 2019
550	.20	Amended by SAS No. 135.	May 2019
550	.22	Amended by SAS No. 135.	May 2019
550	.23	Added by SAS No. 135.	May 2019
550	.26	Amended by SAS No. 135.	May 2019
550	.28	Amended by SAS No. 136.	July 2019
550	.29	Amended by SAS No. 135.	May 2019
550	.A3	Amended by SAS No. 135.	May 2019
550	.A7	Amended by SAS No. 145.	December 2023
550	.A10	Amended by SAS No. 145.	December 2023
550	.A11	Amended by SAS No. 135.	May 2019
550	.A14	Added by SAS No. 135.	May 2019
550	.A15	Amended by SAS No. 128.	January 2015
550	.A16	Amended by SAS No. 135.	May 2019
550	.A17	Amended by SAS No. 128.	January 2015
550	.A17	Amended by SAS No. 135.	May 2019
550	.A18	Amended by SAS No. 135.	May 2019
550	.A20	Amended by SAS No. 135.	May 2019
550	.A21	Amended by SAS No. 145.	December 2023
550	.A22	Amended by SAS No. 128.	January 2015
550	.A22	Amended by SAS No. 135.	May 2019
550	.A26	Amended by SAS No. 135.	May 2019
550	.A27	Amended by SAS No. 135.	May 2019
550	.A28	Amended by SAS No. 135.	May 2019
550	.A29	Amended by SAS No. 135.	May 2019
550	.A30	Amended by SAS No. 145.	December 2023
550	.A36	Amended by SAS No. 135.	May 2019
550	.A38	Amended by SAS No. 145.	December 2023
550	.A42	Amended by SAS No. 135.	May 2019
550	.A43	Amended by SAS No. 135.	May 2019
550	.A44	Amended by SAS No. 135.	May 2019
550	.A45	Amended by SAS No. 135.	May 2019
550	.A52	Amended by SAS No. 135.	May 2019
550	.A53	Amended by SAS No. 135.	May 2019

Section	Paragraph	Changes	Date of Change
560	.03	Amended by SAS No. 136.	July 2019
560	.07	Amended by SAS No. 136.	July 2019
560	.A6	Amended by SAS No. 135.	May 2019
560	.A10	Amended by SAS No. 136.	July 2019
560	.A14	Amended by SAS No. 136.	July 2019
560	.A30	Amended by SAS No. 136.	July 2019
570		Superseded by SAS No. 132.	February 2017
570	.24–.26	Amended by SAS No. 134.	May 2019
570	.29–.30	Amended by SAS No. 134.	May 2019
570	.A37	Amended by SAS No. 136.	July 2019
570	.A51–.A52	Added by SAS No. 134.	May 2019
570	.A54–.A55	Amended by SAS No. 134.	May 2019
570	.A56	Added by SAS No. 134.	May 2019
570	.A57	Amended by SAS No. 134.	May 2019
570	.A60	Amended by SAS No. 136.	July 2019
570	.A62	Amended by SAS No. 134.	May 2019
570	.A65	Added by SAS No. 134.	May 2019
580	.16	Amended by SAS No. 143.	December 2023
580	.17	Amended by SAS No. 135.	May 2019
580	.A13	Amended by SAS No. 143.	December 2023
580	[.A14]	Deleted by SAS No. 143.	December 2023
580	.A16	Amended by SAS No. 135.	May 2019
580	.A18	Amended by SAS No. 135.	May 2019
580	.A35	Amended by SAS No. 143.	December 2023
580	.A38	Amended by SAS No. 136.	July 2019
600	.25	Amended by SAS No. 127.	January 2013
600	.26	Added by SAS No. 127.	January 2013
600	.28	Amended by SAS No. 127.	January 2013
600	.32	Amended by SAS No. 127.	January 2013
600	.32	Amended by SAS No. 138.	December 2019
600	.41	Amended by SAS No. 135.	May 2019
600	.50	Amended by SAS No. 127.	January 2013
600	.A35	Amended by SAS No. 128.	January 2015
600	.A53	Amended by SAS No. 127.	January 2013
600	.A54–.A56	Added by SAS No. 127.	January 2013
600	.A57	Amended by SAS No. 127.	January 2013
600	.A60	Amended by SAS No. 127.	January 2013
600	.A63	Amended by SAS No. 138.	December 2019
600	.A83	Amended by SAS No. 128.	January 2015
600	.A94	Amended by SAS No. 128.	January 2015
600	.A94	Amended by SAS No. 135.	May 2019

Section	Paragraph	Changes	Date of Change
600	.A96	Amended by SAS No. 128.	January 2015
600	.A97	Amended by SAS No. 127.	January 2013
600	.A97	Amended by SAS No. 134.	May 2019
600	.A97	Amended by SAS No. 137.	July 2019
600	.A97	Amended by SAS No. 138.	December 2019
600		Superseded by SAS No. 149.	March 2023
610		Superseded by SAS No. 128.	February 2014
610	.05	Amended by SAS No. 145.	December 2023
610	.A3	Amended by SAS No. 145.	December 2023
610	.A12	Amended by SAS No. 145.	December 2023
610	.A26	Amended by SAS No. 145.	December 2023
620	.A5	Amended by SAS No. 145.	December 2023
620	.A10	Amended by SAS No. 144.	June 2021
620	.A20–.A22	Amended by SAS No. 144.	June 2021
620	.A30–.A31	Amended by SAS No. 144.	June 2021
620	.A35	Amended by SAS No. 144.	June 2021
620	.A40–.A41	Amended by SAS No. 144.	June 2021
620	.A43	Added by SAS No. 144.	June 2021
620	.A45	Added by SAS No. 144.	June 2021
700		Superseded by SAS No. 134.	May 2019
700	.08	Amended by SAS No. 141.	May 2020
700	.15	Amended by SAS No. 143.	December 2023
700	.35	Amended by SAS No. 138.	December 2019
700	.38	Added by SAS No. 137.	July 2019
700	.A2	Amended by SAS No. 137.	July 2019
700	.A14	Amended by SAS No. 138.	December 2019
700	.A81	Amended by SAS No. 137.	July 2019
701		Added by SAS No. 134.	May 2019
701	.05	Amended by SAS No. 141.	May 2020
701	.08	Amended by SAS No. 143.	December 2023
701	.A18	Amended by SAS No. 145.	December 2023
703		Added by SAS No. 136	July 2019
703	.13	Amended by SAS No. 141.	May 2020
703	.18	Amended by SAS No. 145.	December 2023
703	.20	Amended by SAS No. 145.	December 2023
703	.40	Amended by SAS No. 143.	December 2023
703	.74	Amended by SAS No. 138.	December 2019
703	.114	Amended by SAS No. 138.	December 2019
703	.127	Amended by SAS No. 140.	April 2020
703	.A19–.A20	Amended by SAS No. 145.	December 2023
703	.A69	Amended by SAS No. 138.	December 2019

Section	Paragraph	Changes	Date of Change
703	.A148	Amended by SAS No. 140.	April 2020
703	.A153	Amended by SAS No. 145.	December 2023
703	.A154	Amended by SAS No. 140.	April 2020
705		Superseded by SAS No. 134.	May 2019
705	.04	Amended by SAS No. 141.	May 2020
705	.30	Amended by SAS No. 137.	July 2019
705	.A36	Amended by SAS No. 137.	July 2019
705	.A38	Amended by SAS No. 137.	July 2019
706		Superseded by SAS No. 134.	May 2019
706	.03	Amended by SAS No. 137.	July 2019
706	.05	Amended by SAS No. 141.	May 2020
706	.A17	Amended by SAS No. 137.	July 2019
706	.A19	Amended by SAS No. 140.	April 2020
708	.A9	Amended by SAS No. 136.	July 2019
720		Superseded by SAS No. 137.	July 2019
720	.10	Amended by SAS No. 141.	May 2020
720	.A34	Amended by SAS No. 145.	December 2023
720	.A55	Amended by SAS No. 145.	December 2023
725	.01	Amended by SAS No. 136.	July 2019
725	.09	Amended by SAS No. 140.	April 2020
725	.A2	Amended by SAS No. 137.	July 2019
725	.A16	Amended by SAS No. 125.	December 2011
725	.A17	Amended by SAS No. 140.	April 2020
730	.07–.09	Amended by SAS No. 140.	April 2020
730	.A1	Amended by SAS No. 137.	July 2019
730	.A3	Amended by SAS No. 140.	April 2020
800	.01	Amended by SAS No. 127.	January 2013
800	.07	Amended by SAS No. 127.	January 2013
800	.11	Amended by SAS No. 127.	January 2013
800	.18	Amended by SAS No. 127.	January 2013
800	.14	Added by SAS No. 139	March 2020
800	.15	Amended by SAS No. 139	March 2020
800	.18	Amended by SAS No. 139	March 2020
800	.19	Amended by SAS No. 139	March 2020
800	.20	Amended by SAS No. 125.	December 2011
800	.20	Amended by SAS No. 127.	January 2013
800	.20	Amended by SAS No. 139	March 2020
800	.21	Amended by SAS No. 139	March 2020
800	.23	Amended by SAS No. 139	March 2020
800	.A4–.A5	Amended by SAS No. 127.	January 2013
800	.A5	Added by SAS No. 139	March 2020

Section	Paragraph	Changes	Date of Change
800	.A6	Amended by SAS No. 139	March 2020
800	.A8	Amended by SAS No. 127.	January 2013
800	.A11	Amended by SAS No. 139	March 2020
800	.A12	Amended by SAS No. 139	March 2020
800	.A15	Deleted by SAS No. 139	March 2020
800	.A18	Added by SAS No. 139	March 2020
800	.A20	Added by SAS No. 139	March 2020
800	.A21	Added by SAS No. 139	March 2020
800	.A22	Added by SAS No. 139	March 2020
800	.A24	Amended by SAS No. 127.	January 2013
800	.A25	Amended by SAS No. 139	March 2020
800	.A26–.A27	Amended by SAS No. 125.	December 2011
800	.A28	Amended by SAS No. 139	March 2020
800	.A33	Amended by SAS No. 125.	December 2011
800	.A33	Amended by SAS No. 127.	January 2013
800	.A34	Amended by SAS No. 139	March 2020
800	.A39	Amended by SAS No. 139	March 2020
800	.A40	Amended by SAS No. 139	March 2020
800	.A41	Amended by SAS No. 139	March 2020
805	.A1	Amended by SAS No. 139	March 2020
805	.A2	Added by SAS No. 139	March 2020
805	.A3	Amended by SAS No. 139	March 2020
805	.A4	Amended by SAS No. 139	March 2020
805	.A7	Amended by SAS No. 145.	December 2023
805	.A8	Amended by SAS No. 139	March 2020
805	.A11	Added by SAS No. 139	March 2020
805	.A13	Amended by SAS No. 139	March 2020
805	.A14	Amended by SAS No. 139	March 2020
805	.A15	Added by SAS No. 139	March 2020
805	.A17	Amended by SAS No. 139	March 2020
805	.A18	Amended by SAS No. 139	March 2020
805	.A20	Amended by SAS No. 139	March 2020
805	.A21	Added by SAS No. 139	March 2020
805	.A23	Added by SAS No. 139	March 2020
805	.A24	Added by SAS No. 139	March 2020
805	.A25	Added by SAS No. 139	March 2020
805	.A26	Added by SAS No. 139	March 2020
805	.A28	Added by SAS No. 139	March 2020
805	.A29	Amended by SAS No. 139	March 2020
805	.A32	Amended by SAS No. 139	March 2020
805	.A33	Amended by SAS No. 139	March 2020

Section	Paragraph	Changes	Date of Change
805	.A34	Amended by SAS No. 139	March 2020
806	.12–.13	Amended by SAS No. 125.	December 2011
806	.A6–.A8	Amended by SAS No. 125.	December 2011
810	.15	Amended by SAS No. 139	March 2020
810	.18	Amended by SAS No. 139	March 2020
810	.19	Amended by SAS No. 139	March 2020
810	.20	Amended by SAS No. 139	March 2020
810	.26	Amended by SAS No. 139	March 2020
810	.27	Amended by SAS No. 137.	July 2019
810	.A1	Amended by SAS No. 139	March 2020
810	.A15	Added by SAS No. 139	March 2020
810	.A16	Added by SAS No. 139	March 2020
810	.A20	Amended by SAS No. 137.	July 2019
810	.A24	Amended by SAS No. 139	March 2020
905		Superseded by SAS No. 125.	December 2011
905	.11	Amended by SAS No. 130.	December 2016
910		Superseded by SAS No. 124.	October 2011
910	.A11	Amended by SAS No. 134.	May 2019
910	.A11	Amended by SAS No. 138.	December 2019
910	.A11	Amended by SAS No. 140.	April 2020
915	.09	Amended by SAS No. 123.	October 2011
915	.14	Amended by SAS No. 123.	October 2011
915	.14	Amended by SAS No. 125.	December 2011
915	.A6	Amended by SAS No. 125.	December 2011
920	.29	Amended by SAS No. 140.	April 2020
920	[.32]	Deleted by SAS No. 125.	December 2011
920	.33	Amended by SAS No. 125.	December 2011
920		Amended by SAS No. 129.	July 2014
920	.A29	Amended by SAS No. 140.	April 2020
920	.A34	Amended by SAS No. 125.	December 2011
930	.11	Amended by SAS No. 145.	December 2023
930	.A7	Amended by SAS No. 145.	December 2023
930	.A11	Amended by SAS No. 145.	December 2023
930	.22	Amended by SAS No. 135.	May 2019
930	.31	Amended by SAS No. 140.	April 2020
930	.38	Amended by SAS No. 140.	April 2020
930	.39	Added by SAS No. 140.	April 2020
930	[.A20–.A21]	Deleted by SAS No. 140.	April 2020
930	.A32	Amended by SAS No. 135.	May 2019
930	.A41	Added by SAS No. 140.	April 2020
930	.A45–.A60	Added by SAS No. 140.	April 2020

Section	Paragraph	Changes	Date of Change
930	.A59	Amended by SAS No. 135.	May 2019
930	.A68–.A69	Amended by SAS No. 140.	April 2020
930	.A70	Added by SAS No. 140.	April 2020
930	.A79–.A81	Amended by SAS No. 140.	April 2020
935	.02	Amended by SAS No. 148.	December 2022
935	.04	Amended by SAS No. 140.	April 2020
935	.08	Amended by SAS No. 140.	April 2020
935	.10–.11	Amended by SAS No. 140.	April 2020
935	.12	Amended by SAS No. 148.	December 2022
935	.16–.17	Amended by SAS No. 140.	April 2020
935	.16	Added by SAS No. 148.	December 2022
935	.18	Amended by SAS No. 148.	December 2022
935	.19–.21	Added by SAS No. 148.	December 2022
935	.23	Amended by SAS No. 140.	April 2020
935	.24	Amended by SAS No. 148.	December 2022
935	.30–.31	Amended by SAS No. 123.	October 2011
935	.30–.31	Amended by SAS No. 140.	April 2020
935	[.32]	Deleted by SAS No. 140.	April 2020
935	.30–.31	Amended by SAS No. 125.	December 2011
935	.34	Amended by SAS No. 140.	April 2020
935	.35	Added by SAS No. 140.	April 2020
935	[.36]	Deleted by SAS No. 140.	April 2020
935	.38	Amended by SAS No. 140.	April 2020
935	.44	Amended by SAS No. 148.	December 2022
935	.A1–.A2	Amended by SAS No. 140.	April 2020
935	.A7	Amended by SAS No. 140.	April 2020
935	.A9–.A11	Amended by SAS No. 140.	April 2020
935	.A12	Amended by SAS No. 148.	December 2022
935	.A14	Amended by SAS No. 148.	December 2022
935	.A15–.A16	Added by SAS No. 148.	December 2022
935	.A16–.A17	Amended by SAS No. 140.	April 2020
935	.A18–.A19	Amended by SAS No. 148.	December 2022
935	.A21	Amended by SAS No. 140.	April 2020
935	.A24–.A26	Amended by SAS No. 140.	April 2020
935	.A25	Amended by SAS No. 148.	December 2022
935	[.A33]	Deleted by SAS No. 125.	December 2011
935	.A34–.A35	Added by SAS No. 140.	April 2020
935	.A37–.A38	Amended by SAS No. 140.	April 2020
935	.A41	Amended by SAS No. 123.	October 2011
935	.A42–.A44	Amended by SAS No. 140.	April 2020
935	.A45–.A46	Amended by SAS No. 148.	December 2022

Section	Paragraph	Changes	Date of Change
940		Added by SAS No. 130.	October 2015
940	.26	Amended by SAS No. 140.	December 2023
940	.31	Amended by SAS No. 140.	December 2023
940	.57	Amended by SAS No. 140.	December 2023
940	.64–.66	Amended by SAS No. 140.	April 2020
940	.69–.70	Amended by SAS No. 140.	April 2020
940	.75–.76	Amended by SAS No. 140.	April 2020
940	.80	Amended by SAS No. 140.	April 2020
940	.86	Amended by SAS No. 140.	April 2020
940	.A6	Added by SAS No. 145.	December 2023
940	.A22	Amended by SAS No. 145.	December 2023
940	.A25	Amended by SAS No. 135.	May 2019
940	.A26–.A27	Amended by SAS No. 143.	December 2023
940	.A34	Amended by SAS No. 143.	December 2023
940	.A51–.A52	Amended by SAS No. 143.	December 2023
940	.A91	Amended by SAS No. 135.	May 2019
940	.A113	Amended by SAS No. 140.	April 2020
940	[.A114]	Deleted by SAS No. 140.	April 2020
940	.A117	Added by SAS No. 140.	April 2020
940	.A130	Amended by SAS No. 140.	April 2020
940	.A155	Amended by SAS No. 140.	April 2020
940	.A158	Amended by SAS No. 140.	April 2020
945	.01–.A38	Added by SAS No. 133.	July 2017
945	.09	Amended by SAS No. 137.	July 2019
945	.A27	Amended by SAS No. 137.	July 2019

AU-C Appendix F

Other Auditing Publications

This listing identifies *other auditing publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate as defined in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Products may be obtained through https://www.aicpa.org/cpe-learning.

Technical Questions and Answers

- Q&A section 8000, *Audit Field Work*
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